NATIONAL TAXPAYER ADVOCATE

2012 ANNUAL REPORT TO CONGRESS

Volume One

TAXPAYER ADVOCATE SERVICE

YOUR VOICE AT THE IRS

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Dedication

To my dear friend
Christine Brunswick,

Whose extraordinary service to the tax system
As Executive Director
of the
American Bar Association Tax Section
Over 25 years
Is unparalleled.

But most importantly,
She has taught me how to live
With grace in the face of adversity.

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Honorable Members of Congress:

I respectfully submit for your consideration the National Taxpayer Advocate's 2012 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

As this report goes to press, it appears an agreement has been reached to patch the Alternative Minimum Tax. For taxpayers and the IRS, that is extremely good news. The IRS systems that process tax returns cannot generally be programmed to accommodate alternative scenarios. As the IRS Commissioner has said, the IRS made a risk-based decision to program its systems on the assumption that an AMT patch would be passed, and if a patch was not enacted, the start of the filing season would have been delayed from January to late March or possibly later for the significant majority of taxpayers. That would have brought about the most chaotic filing season in memory. I am hopeful and relieved that that near-crisis seems to have been averted.

Since the election, the dominant issue before Congress has been the so-called "fiscal cliff." While that term seems to mean different things to different people, it encompasses three critical issues from a tax administration perspective — tax complexity, the Alternative Minimum Tax, and the risk that sequestration or alternative budget cuts will further weaken the IRS's ability to serve taxpayers and collect the revenue upon which the rest of government depends.

Consider the following:

- **Tax Complexity.** An analysis of IRS data by the Office of the Taxpayer Advocate shows it takes U.S. taxpayers (both individuals and businesses) more than 6.1 billion hours to complete filings required by a tax code that contains almost four million words and that, on average, has more than one new provision added to it daily. Indeed, few taxpayers complete their returns without assistance. Nearly 60 percent of taxpayers hire paid preparers and another 30 percent rely on commercial software to prepare their returns. To inspire confidence and trust, the tax laws should be comprehensible and the computations of tax should be transparent and relatively simple, yet few taxpayers today can confidently say they understand the tax code or even that they have correctly computed their tax liabilities.[1] In this report, we identify tax complexity as the #1 most serious problem facing taxpayers, and we recommend (as we have in prior reports) that Congress vastly simplify the tax code to make tax compliance easier. We offer both conceptual and specific suggestions for Congress to consider as it moves forward.
- **Alternative Minimum Tax.** Taxpayers spent about 18 million hours for the 2000 tax year (the most recent year for which we found data) completing and filling out AMT tax forms and determining whether they owed the tax. The AMT was originally enacted to ensure that the wealthiest U.S. taxpayers pay at least some tax each year by adding back into income certain tax benefits known as "tax preferences." Yet in 2008, 87 percent of all tax preferences that

1 *See* Most Serious Problem: *The Complexity of the Tax Code*, *infra*.

gave rise to AMT liabilities was attributable to the disallowance of personal exemptions and the deduction for state and local taxes. Only under the unique logic of the AMT are the acts of having a large family and living in a high-tax state viewed as a tax dodge. As we document in this report, the AMT does not seem to achieve its intended purpose. Many middle and upper-middle class taxpayers pay the AMT, while most wealthy taxpayers do not, and thousands of millionaires pay no income tax at all. At the same time, the AMT adds significant complexity to tax computations, requiring millions of taxpayers essentially to compute their tax liabilities twice — once under the regular tax rules and again under the AMT rules — and then to pay the higher of the two tax amounts. Because the AMT largely fails to achieve its objective and because it adds considerable complexity for so many taxpayers, including millions who don't even end up owing it, we identify the AMT as the #2 most serious problem facing taxpayers, and we reiterate our longstanding recommendation that the AMT be repealed.

- **IRS Funding.** In fiscal year (FY) 2012, the IRS received around 125 million calls. The IRS answered only about two out of three calls from taxpayers trying to reach a live person, and those taxpayers had to wait, on average, about 17 minutes to get through. Meanwhile, at fiscal year end, the IRS had a backlog of more than one million pieces of correspondence (up 188 percent from FY 2004), and almost half of that backlog was overage (up 316 percent from FY 2004). Is it any wonder that some taxpayers give up and stop responding to the IRS?[2] At the same time that the IRS is not meeting taxpayer needs, it is struggling to close a "tax gap" estimated at nearly $400 billion a year. In this report, we designate the significant and persistent underfunding of the IRS as the #3 most serious problem facing taxpayers.

To elaborate on this funding challenge, no business would fail to fund a unit that, on average, brought in $7 for every dollar spent. Shareholders would rebel and bring lawsuits, or at least oust the management or board of directors.

Yet this is precisely what we are doing with the IRS budget. Last year, the IRS brought in federal revenue of about $2.52 trillion on a budget of $11.8 billion, for a return-on-investment (ROI) of 214:1. If we cut IRS funding, the IRS Commissioner recently estimated in a letter to Congress that we can expect lower tax collections in an amount seven times as much as the budget cuts. That means fewer dollars to put toward deficit reduction, fewer dollars for military funding, fewer dollars for disaster recovery, fewer dollars for our intelligence services and embassy protection, fewer dollars for an economic safety net, fewer dollars for disaster recovery, fewer dollars for infrastructure renewal, fewer dollars for medical research — in short, fewer dollars for all the things we believe as a nation we should provide for our citizens. It means real harm to real people.

Since FY 2010, the IRS budget has been declining each year, and absent congressional action, it is likely to be reduced more in the coming years, perhaps significantly so, by sequestration or other budget cuts that replace the sequestration mechanism. More than 90 percent of the IRS's taxpayer service and enforcement budget goes for personnel costs, so budget cuts mean that fewer employees

2 *See* Most Serious Problem: *The IRS is Significantly Underfunded to Serve Taxpayers and Collect Tax*, *infra*.

will be available to answer phone calls from taxpayers needing assistance.[3] Budget cuts mean that there will be long delays when taxpayers call or write to say there is a mistake on their IRS bill and they don't owe these taxes.[4] Budget cuts mean that victims of identity theft will have to wait longer than six months to get resolution of their cases and receive their refunds.[5] Budget cuts mean that because taxpayers couldn't get the assistance they needed when they needed it, they will do things incorrectly. Budget cuts mean that, because of these avoidable problems, taxpayers will face IRS enforcement actions — liens, levies, seizures, audits — that will be automated and initiated without so much as a phone call to the actual taxpayer.[6] And budget cuts mean that the IRS will not have the trained personnel or technology required to administer the laws properly to close the tax gap.

None of this bodes well for taxpayers. But the harm from budget brinksmanship and last-minute tax law changes goes beyond the immediate impacts I've outlined above. As we report in our Volume Two study, *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, the factors that are most highly correlated with noncompliance among sole proprietors — the single largest component of the tax gap — are distrust of government, distrust of the IRS, and disbelief in the fairness of our tax system. The fiscal cliff drama reinforces taxpayers' belief that government and the tax system are not helping them.

Under our system of government, it may be inevitable that important decisions about tax policy and federal budgeting are sometimes deferred until the last minute. But the extent of the resulting uncertainty about tax rates, people's take-home pay, the AMT, and the prospect of a delay in the delivery of tax refunds resulting from a delay in the start of the filing season produces disappointment, dismay, and cynicism among taxpayers. The IRS budget cuts likely to come about with sequestration (or replacement cuts), and the virtual freeze on hiring and training that has already occurred because of successive years of continuing resolutions and inadequate funding, erode what little taxpayer service remains in IRS operations and all but ensure that IRS technology will remain in the 20th century, hampering its ability to effectively collect tax and assist taxpayers who are trying to comply. Meanwhile, the complexity creep of the tax code and the menacing shadow of the AMT confirm taxpayers' suspicions that the tax laws are designed to entrap them and obscure what is and is not being taxed.

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3 *See* Most Serious Problem: *The IRS Telephone and Correspondence Services Have Deteriorated Over the Last Decade and Must Improve to Meet Taxpayer Needs*, *infra*.

4 *See* Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively*, *infra*.

5 *See* Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*, *infra*.

6 *See* Introduction: *The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes*, *infra*; Most Serious Problem: *The Diminishing Role of the Revenue Officer Has Been Detrimental To The Overall Effectiveness Of IRS Collection Operations*, *infra*; Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively*, *infra*; Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced The Number Of Lien Notices Filed, the IRS Has Failed To Determine Whether Its Lien Policies Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*, *infra*; Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*, *infra*; Study: *Study of Tax Court Cases In Which the IRS Conceded the Taxpayer Was Entitled to the Earned Income Tax Credit (EITC)*, *infra*; and Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, *infra*.

The fiscal cliff also deflects attention from other priority issues in tax administration, including the 20 other most serious problems we identify in this report. At its most basic level, insufficient funding drives the IRS to reduce its meaningful interaction with taxpayers and replace it with automated enforcement mechanisms. This approach can erode fundamental taxpayer rights and protections. We see evidence of this erosion in the IRS's failure to provide adequate assistance to victims of identity theft or return preparer fraud;[7] its insistence on draconian penalties against taxpayers with overseas accounts, irrespective of their benign purpose;[8] its inadequate use of installment agreements and offers in compromise for taxpayers, particularly with respect to business taxpayers and taxpayers experiencing economic hardship;[9] and its abandonment of an education and compliance presence in local communities.[10] All of these are problems for which solutions exist and about which my office has made practical recommendations.

Yet throughout this report, the IRS responses to our analysis and recommendations often seem to miss the basic point or are otherwise unpersuasive. What underlies these responses is the understandable IRS concern that it does not have the resources to make the improvements that are so obviously needed, so it is better to rationalize the *status quo* or commit to only those improvements it can afford currently, rather than try to make the case for more funding or for reallocating current funding. The current budget crisis and recurring continuing resolutions exacerbate this IRS tendency.

This is no way to run a tax system. What the IRS — and its taxpayers — need is a stable funding mechanism for the IRS that allows it to educate its taxpayers about their tax obligations, provide assistance to taxpayers when they need it, work with taxpayers who are trying to comply but aren't in compliance for one reason or another (including economic hardship), enforce the tax laws against those who seek to evade reporting their taxable income or paying their tax liabilities, and generally seek to increase the amount of taxes paid voluntarily.

What the IRS — and its taxpayers — have now is an unstable funding mechanism that treats the IRS like any other government spending program instead of the revenue center or accounts receivable function that it is. The IRS must compete for funding with the rest of the government agencies that rely on IRS collections to accomplish their missions. The plain truth is that the IRS's mission trumps all other agencies' missions — because without an effective revenue collector you can't fund those other agencies. Certainly, Members of Congress may disagree about the appropriate level of taxation. But whatever level is written into law, there can be little disagreement that taxpayers should receive the assistance they need to comply, and the laws should be enforced so

7 See Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*, *infra*; Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully*, *infra*.

8 See Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*, *infra*.

9 See Introduction: *The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes*, *infra*; Most Serious Problem: *The Diminishing Role of the Revenue Officer Has Been Detrimental To The Overall Effectiveness Of IRS Collection Operations*, *infra*; Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*, *infra*.

10 See Most Serious Problem: *The IRS Is Substantially Reducing Both the Amount and Scope of Its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of Its Remaining Outreach Activities, Thereby Risking Increased Noncompliance*, *infra*.

that everyone pays their fair share of tax and we have a level playing field. Without an effective tax collector, honest taxpayers end up paying more to subsidize noncompliance by others, and we don't raise the funds our government requires. And that state of affairs is not sustainable.

In this and previous reports, we have proposed a solution to the problem of IRS funding.[11] It is really very simple in concept: fence off — or "sequester," if you will — IRS funding from the rest of the federal budget. Determine what level of revenue the IRS needs to collect for the government to do what we want it to do, and then determine what the IRS needs to collect that revenue — in a way that maximizes (voluntary) compliance, protects taxpayer rights, and minimizes taxpayer burden. The return on investment in the IRS should be guaranteed to be greater than 1 to 1. And if we simultaneously set goals for the IRS in terms of taxpayer service, victim assistance, online services, and voluntary compliance while funding research, development, and innovation, we may well exceed our ROI expectations. We might actually end up with the 21st century tax administration we deserve rather than the heroically struggling, overwhelmed one that we have.

Looking forward, the year 2013 is shaping up to be an active one from the standpoint of tax policy. As Congress moves forward on these fronts, I urge you to keep in mind the impact of various legislative proposals on the taxpayer and on the IRS's ability to administer the proposals effectively and fairly. As the National Taxpayer Advocate, I hope 2013 brings about fundamental tax simplification, repeal of the Alternative Minimum Tax, and a new approach toward funding the IRS that ensures the agency can do a better job of meeting taxpayer needs and collecting the revenue that funds virtually all other government operations. I also hope the IRS makes progress in addressing the growing problem of tax-related identity theft and particularly improves its performance in providing timely and effective assistance to identity-theft victims and preparer fraud victims as well as taxpayers who are struggling to comply with their tax obligations.

I respectfully submit this report to Congress for your consideration and action, and I stand ready to assist you in any way that I can.

Sincerely,

Nina E. Olson
National Taxpayer Advocate
31 December 2012

11 *See* Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*, *infra*; *see also* National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

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National Taxpayer Advocate 2012 Annual Report to Congress

APPENDICES

Volume Two: TAS Research and Related Studies

Introduction: The Most Serious Problems Encountered By Taxpayers

Internal Revenue Code (IRC) § 7803(c)(2)(b)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2012, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS in resolving 23 such problems. This year's report also includes status updates on six issues previously raised by the National Taxpayer Advocate or addressed in previous Annual Reports. Among these is an update on virtual face-to-face service, which the National Taxpayer Advocate has recommended since the 2008 report.[1]

As in earlier years, this report discusses at least 20 *of the most serious problems* encountered by taxpayers — but not necessarily the top 20 most serious problems. That is by design. Since there is no objective way to select the 20 most serious problems, we consider a variety of factors when making this determination. Moreover, while we carefully rank each year's problems under the same methodology (described immediately below), the list remains inherently subjective in many respects.

To simply report on the top 20 problems would pose many difficulties. First, in doing so, it would require us to repeat much of the same data and propose many of the same solutions year to year. Thus, the statute allows the National Taxpayer Advocate to be flexible in selecting both the subject matter and the number of topics to be discussed and to use the report to put forth actionable and specific solutions instead of mere criticism and complaints.

METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. The 23 issues and the six status updates in this section of the Annual Report were ranked according to the following criteria:

- Impact on taxpayer rights;
- Number of taxpayers affected;
- Interest, sensitivity, and visibility to the National Taxpayer Advocate, Congress, and other external stakeholders;
- Barriers these problems present to tax law compliance, including cost, time, and burden;
- The revenue impact of noncompliance; and
- Taxpayer Advocate Management Information System (TAMIS) and Systemic Advocacy Management System (SAMS) data.

[1] *See* National Taxpayer Advocate 2010 Annual Report to Congress 267-277 (Most Serious Problem: *The IRS Has Been Reluctant to Implement Alternative Service Methods that Would Improve Accessibility for Taxpayers Who Seek Face-to-Face Assistance*); and National Taxpayer Advocate 2008 Annual Report to Congress 95-113 (Most Serious Problem: *Taxpayer Service: Bringing Service to the Taxpayer*).

After reviewing this ranking, the National Taxpayer Advocate identified three issues which are, in her judgment after taking into consideration all of the above factors, the ones most in need of attention and thus requiring the most prominent placement in the ranking. Finally, the National Taxpayer Advocate and the Office of Systemic Advocacy examine the results of the ranking on the remaining issues and adjust it where editorial or numeric considerations warrant a particular placement or grouping. This year, the remaining 20 problems are further grouped under specific, focused categories, including victim assistance and taxpayer rights. The report contains separate introductions for the categories of taxpayer service in the 21st century and taxpayer service within collection.

TAXPAYER ADVOCATE MANAGEMENT INFORMATION SYSTEM LIST

The identification of the most serious problems reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy — using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2012, a period spanning October 1, 2011, through September 30, 2012.

IRS RESPONSES

TAS provides the IRS's respective operating divisions and functional units with the opportunity to comment on and respond to the problems described in each year's report. For each most serious problem, these responses appear unedited (with the exception of correcting typographical or clerical errors), under the heading "IRS Comments," followed by the National Taxpayer Advocate's own comments on the IRS response and her final recommendations.

USE OF EXAMPLES

The examples presented in this report illustrate issues raised in cases handled by TAS. To comply with IRC § 6103, which generally requires the IRS to keep taxpayers' returns and return information confidential, the details of the fact patterns have been changed. In some instances, the taxpayer has provided a written waiver to the National Taxpayer Advocate to use facts specific to that taxpayer's case. These exceptions are noted in footnotes to the examples.

MSP #1

The Complexity of the Tax Code

DEFINITION OF PROBLEM

The most serious problem facing taxpayers — and the IRS — is the complexity of the Internal Revenue Code (the "tax code"). Among other things, the tax code:

- Makes compliance difficult, requiring taxpayers to devote excessive time to preparing and filing their returns;
- Requires the significant majority of taxpayers to bear monetary costs to comply, as most taxpayers hire preparers and many other taxpayers purchase tax preparation software;
- Obscures comprehension, leaving many taxpayers unaware how their taxes are computed and what rate of tax they pay;
- Facilitates tax avoidance by enabling sophisticated taxpayers to reduce their tax liabilities and by providing criminals with opportunities to commit tax fraud;
- Undermines trust in the system by creating an impression that many taxpayers are not compliant, thereby reducing the incentives that honest taxpayers feel to comply; and
- Generates tens of millions of telephone calls to the IRS each year, overburdening the agency and compromising its ability to provide high-quality taxpayer service.

In 2012, TAS conducted a statistically representative national survey of over 3,300 taxpayers who operate businesses as sole proprietors. Only 16 percent said they believe the tax laws are fair.[1] Only 12 percent said they believe taxpayers pay their fair share of taxes.[2] The National Taxpayer Advocate finds this extraordinary lack of public trust in the method by which our government is funded profoundly disturbing.

To alleviate taxpayer burden and enhance public confidence in the integrity of the tax system, the National Taxpayer Advocate urges Congress to vastly simplify the tax code. In general, this means paring back the number of income exclusions, exemptions, deductions, and credits (generally known as "tax expenditures"). For fiscal year (FY) 2013, the Joint Committee on Taxation has projected that tax expenditures will come to about $1.09 trillion,[3] while individual income tax revenue is projected to be about $1.36 trillion.[4] This suggests that if Congress were to eliminate all tax expenditures, it could cut individual

1 Russell Research, Inc., *Factors Influencing Compliance: Topline Summary* (May 2012). Russell Research conducted this survey for TAS. A detailed presentation and analysis of the survey results is published in Volume 2 of this report. *See* Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*.

2 *Id*.

3 *See* Staff of the Joint Committee on Taxation, 112th Cong., *Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015* (Joint Comm. Print 2012), *at* https://www.jct.gov/publications.html?func=select&id=5.

4 *See* Office of Management and Budget, Budget of the United States Government, Fiscal Year 2013, Historical Tables, Table 2.1, *at* http://www.whitehouse.gov/omb/budget/Historicals.

income tax rates by about 44 percent and still generate about the same amount of revenue.[5] The Treasury Department also makes annual tax expenditure estimates, and for FY 2013, it projects tax expenditures of $1.02 trillion, which would allow for a 43 percent reduction in tax rates under similar assumptions.[6]

As this report goes to press, we are well aware that the subject of tax reform is figuring prominently in the political dialogue over ways to reduce the federal budget deficit. The National Taxpayer Advocate does not take a position regarding optimal revenue levels, tax rates, or the distribution of tax liabilities. As the statutory voice of the taxpayer, the National Taxpayer Advocate is recommending tax reform for the purpose of reducing taxpayer burden. As discussed below, the existing tax code inflicts significant, even unconscionable, burden on taxpayers, and Congress could alleviate much of that burden by vastly simplifying the tax code. Thus, our advocacy for tax reform is longstanding and wholly unrelated to deficit reduction.

In 1986, the last time Congress enacted fundamental tax reform, the legislation proceeded on a revenue-neutral basis. That approach had the virtue of allowing policymakers to assure taxpayers that, at least on average, their tax bills would not rise. If tax reform is undertaken now as part of an effort to raise revenue, that assurance cannot be given. But the same structural tradeoffs will apply. Once Congress sets its revenue targets, it can hit its targets by enacting relatively high tax rates that continue to be offset by a bewildering array of exclusions, exemptions, deductions, and credits, or it can hit its targets by enacting relatively low tax rates and minimizing the number of tax breaks it permits.

From the standpoint of reducing taxpayer burden, simpler is better. As we have suggested in the past, we recommend that Congress employ a "zero-based budgeting" approach to tax reform. The starting point for discussion would be a tax code without any exclusions or reductions in income or tax. A tax break or IRS-administered social program would be added only if lawmakers decide, on balance, that the public policy benefits of running the provision or program through the tax code outweigh the tax complexity burden that the provision creates for taxpayers and the IRS. At the end of the exercise, tax rates can be set

5 We cite this figure as a ballpark estimate. There are at least two important effects that could cause this percentage to be higher or lower in practice. First, if all tax expenditures were eliminated, each taxpayer's taxable income would increase substantially (*e.g.*, by 44 percent), and as taxable income rises, taxpayers move into higher marginal tax-rate brackets. Therefore, the additional taxable income would fall into the higher bracket levels, causing taxpayers to pay more in tax. This mechanical effect suggests Congress could cut tax rates by more than 44 percent and still raise the same amount of revenue. Second, tax expenditures have certain interactive effects that tend to push in the opposite direction. Thus, if all tax expenditures were eliminated simultaneously, the interactive effects would probably cause the additional tax revenue to be somewhat less than the sum of the tax expenditures eliminated. TAS does not have a revenue-estimation capacity, so we cannot determine whether the combination of these effects would, on balance, produce more revenue or less revenue. Nevertheless, the aggregate total provides a rough approximation of the increase in revenue that would result from the elimination of all tax expenditures, and we use it in this report for that purpose. *See* Leonard Burman, Eric Toder & Christopher Geissler, *How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?* Discussion Paper 31, Amer. Soc. Sci. Assoc'n (New Orleans, La., Jan. 5, 2008) 3, *at* http://taxpolicycenter.org/UploadedPDF/1001234_tax_expenditures.pdf; shorter version published in 98 *Amer. Econ. Rev.* 79 (2008) (stating that despite interaction effects, "commentators have added up tax expenditures to make general statements about their magnitude").

6 *See* Office of Management and Budget, Budget of the United States Government, Fiscal Year 2013, Supplemental Materials, Tax Expenditures Spreadsheet, Table 17-2, *at* http://www.whitehouse.gov/omb/budget/Supplemental.

at whatever level is required to raise the amount of revenue that Congress determines is appropriate.

ANALYSIS OF PROBLEM

The National Taxpayer Advocate on numerous occasions has identified the complexity of the tax code as the most serious problem facing taxpayers and urged Congress to simplify it. In this section, we quantify the burden the tax code imposes, summarize the largest tax expenditures to make clear that fundamental tax reform will require difficult tradeoffs, share select comments on tax reform from taxpayers, make the case for a "zero-based budgeting" approach, summarize our office's prior tax simplification recommendations in key areas, and propose several recommendations for Congressional consideration.

A. Why is Tax Reform Needed?

1. The Current Tax Code Imposes Huge Compliance Burdens on Individual Taxpayers and Businesses.

Consider the following:

- According to a TAS analysis of IRS data, individuals and businesses spend about 6.1 billion hours a year complying with the filing requirements of the Internal Revenue Code.[7] And that figure does not include the millions of additional hours that taxpayers must spend when they are required to respond to IRS notices or audits.
- If tax compliance were an industry, it would be one of the largest in the United States. To consume 6.1 billion hours, the "tax industry" requires the equivalent of more than three million full-time workers.[8]
- Compliance costs are huge both in absolute terms and relative to the amount of tax revenue collected. Based on Bureau of Labor Statistics data on the hourly cost of an employee, TAS estimates that the costs of complying with the individual and corporate

[7] The TAS Research function arrived at this estimate by multiplying the number of copies of each form filed for tax year 2010 by the average amount of time the IRS estimated it took to complete the form. While the IRS's estimates are the most authoritative available, the amount of time the average taxpayer spends completing a form is difficult to measure with precision. This TAS estimate may be low because it does not take into account all forms and, as noted in the text, it does not include the amount of time taxpayers spend responding to post-filing notices, examinations, or collection actions. Conversely, the TAS estimate may be high because IRS time estimates have not necessarily kept pace fully with technology improvements that allow a wider range of processing activities to be completed via automation.

[8] This calculation assumes each employee works 2,000 hours per year (*i.e.*, 50 weeks, with two weeks off for vacation, at 40 hours per week).

income tax requirements for 2010 amounted to $168 billion — or a staggering 15 percent of aggregate income tax receipts.[9]

- According to a tally compiled by a leading publisher of tax information, there have been approximately 4,680 changes to the tax code since 2001, an average of more than one a day.[10]
- The tax code has grown so long that it has become challenging even to figure out how long it is. A search of the Code conducted using the "word count" feature in Microsoft Word turned up nearly four million words.[11]
- Individual taxpayers find return preparation so overwhelming that about 59 percent now pay preparers to do it for them.[12] Among unincorporated business taxpayers, the figure rises to about 71 percent.[13] An additional 30 percent of individual taxpayers use tax software to help them prepare their returns,[14] with leading software packages costing $50 or more. For 2007, IRS researchers estimated that the monetary compliance burden of the median individual taxpayer (as measured by income) was $258.[15]

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9 The IRS and several outside analysts have attempted to quantify the costs of tax compliance. For an overview of previous studies, see Government Accountability Office, *Tax Policy: Summary of Estimates of the Costs of the Federal Tax System*, GAO-05-878 (Aug. 2005). There is no clearly correct methodology, and the results of these studies vary. All monetize the amount of time that taxpayers and their preparers spend complying with the tax code. TAS estimated the cost of complying with personal and business income tax requirements (and thus excluding the time spent complying with employment, estate and gift, excise, and exempt organization tax requirements) by multiplying the total number of such hours (5.648 billion) by the average hourly cost of a civilian employee ($29.72), as reported by the Bureau of Labor Statistics. *See* Bureau of Labor Statistics, U.S. Department of Labor, *Employer Costs for Employee Compensation – December 2010*, USDL: 11-0304 (Mar. 9, 2011) (including wages and benefits), *at* http://www.bls.gov/news.release/archives/ecec_03092011.pdf. TAS estimated compliance costs as a percentage of total income tax receipts for 2010 by dividing the income tax compliance cost as computed above ($168 billion) by total 2010 income tax receipts ($1.09 trillion). *See* Office of Management and Budget, Budget of the United States Government - Fiscal Year 2013, Historical Tables, Table 2-1, *at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/hist.pdf. TAS's estimate that compliance costs amount to about 15 percent of aggregate income tax receipts falls within the range of some previous estimates. For example, Professor Joel Slemrod computed that compliance costs constitute about 13 percent of receipts, while the Tax Foundation computed that compliance costs constitute about 22 percent of income tax receipts. *See* Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) (statement of Joel Slemrod, Paul W. McCracken Collegiate Professor of Business Economics and Public Policy, University of Michigan Stephen M. Ross School of Business); Scott Moody, Wendy P. Warcholik & Scott A. Hodge, *Special Report: The Rising Cost of Complying with the Federal Income Tax* (Tax Foundation, Dec. 2005), *at* http://www.taxfoundation.org/research/show/1281.html.

10 Unpublished Commerce Clearing House (CCH) data provided to TAS (Dec. 12, 2012). This count does not include changes made after Dec. 28, 2012, if any, as they would have been enacted after our publishing deadline. CCH advised us that its count of tax-law changes is somewhat understated, because multiple changes to a section might be grouped together and counted as a single entry on its finding lists of tax-law changes.

11 To determine the number of words in the Internal Revenue Code, TAS downloaded a zipped file of Title 26 of the U.S. Code (*i.e.*, the Internal Revenue Code) from the website of the U.S. House of Representatives at http://uscode.house.gov/download/title_26.shtml. We unzipped the file, copied it into Microsoft Word, and used the "word count" feature to compute the number of words. The version of Title 26 we used was dated Jan. 3, 2012, so the count does not reflect legislation enacted during the second session of the 112th Congress. In Word, the document ran 9,191 single-spaced pages. The printed code contains certain information that does not have the effect of law, such as a description of amendments that have been adopted, effective dates, cross references, and captions. The word count feature also counts page numbers, the table of contents, and the like. Therefore, our count somewhat overstates the number of words that are officially considered a part of the tax code, although as a practical matter, a person seeking to determine the law will likely have to read and consider many of these additional words, including effective dates, cross references, and captions. Other attempts to determine the length of the Code may have excluded some or all of these components, but there is no clearly correct methodology to use, and we found no easy way to selectively delete information from a document of this length.

12 IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2010).

13 *Id.*

14 *Id.*

15 George Contos, John Guyton, Patrick Langetieg & Melissa Vigil, *Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity* 26 (presented at IRS Research Conference, June 2010).

2. Complexity Obscures Understanding and Creates a Sense of Distance Between Taxpayers and the Government, Resulting in Lower Rates of Voluntary Tax Compliance.

IRS data show that when taxpayers have a choice about reporting their income, tax compliance rates are remarkably low. Workers who are classified as employees have little opportunity to underreport their earned income because it is subject to tax withholding. Employees thus report about 99 percent of their earned income. But among workers whose income is not subject to tax withholding, compliance rates plummet. An IRS study found that nonfarm sole proprietors report only 43 percent of their business income and unincorporated farming businesses report only 28 percent.[16]

Noncompliance cheats honest taxpayers, who indirectly pay more to make up the difference. According to the IRS's most recent comprehensive estimate, the net tax gap stood at $385 billion in 2006,[17] when there were 116 million households in the United States.[18] This means that each household was effectively paying a "surtax" of some $3,300 to subsidize noncompliance by others.

This raises an important question: Why is it that few Americans would steal from their neighbor or a local charity, yet a high percentage of taxpayers who have a choice about paying taxes appear to have no compunctions about cheating their fellow citizens?

The Taxpayer Advocate Service has conducted some research into the causes of noncompliance, including a major study published in volume 2 of this report,[19] and plans to conduct additional studies. While we do not have definitive answers, we can suggest at least two hypotheses.

- First, no one wants to feel like a "tax chump" — paying more while suspecting that others are taking advantage of loopholes to pay less. In a TAS survey of taxpayers conducted this year, 73 percent said "[t]he wealthy have ways of minimizing their Federal taxes that are not available to the average taxpayer" and only 12 percent said, "everyone

16 *See* IRS News Release, *IRS Updates Tax Gap Estimates*, IR-2006-28 (Feb. 14, 2006), *at* http://www.irs.gov/uac/IRS-Updates-Tax-Gap-Estimates (accompanying charts *at* http://www.irs.gov/pub/irs-news/tax_gap_figures.pdf). As low as these rates are, they would be even lower if not for the fact that some of this income is reported to the IRS by third parties. In January 2012, the IRS updated its estimate of the tax gap, but the updated study does not contain a breakout of compliance rates for sole proprietors or unincorporated farming businesses. Thus, the compliance rates cited in the text remain the most recent estimates available.

17 *See* IRS News Release, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, IR-2012-4 (Jan. 6, 2012), *at* http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study. The "net" tax gap reflects the amount by which tax liabilities exceed tax collection after accounting for late payments and enforced collections. The "gross" tax gap – the amount of tax due but not paid timely and before enforced collections – was estimated to be $450 billion.

18 U.S. Census Bureau, Table H-1, *Income Limits for Each Fifth and Top 5 Percent of All Householders: 1967 to 2011*, *at* http://www.census.gov/hhes/www/income/data/historical/household/index.html.

19 *See* Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, vol. 2, *infra*.

pays their fair share of taxes."[20] Taxpayers who believe they are unfairly paying more than others inevitably will feel more justified in "fudging" to right the perceived wrong. Transparency is a critical feature of a successful tax system and is essential if the system is to build taxpayer confidence and maintain high rates of tax compliance. Simplifying the tax code so tax policy choices and computations are more transparent would go a long way toward reassuring taxpayers that the system is not rigged against them.

- Second, most people feel a sense of affinity and unity with local organizations, while in relative terms, they feel disconnected from the federal government. This may be because members of a community generally understand the services that local organizations provide and the benefits they personally derive, while many Americans do not understand how their tax dollars are spent or how they benefit. It may also be because they know the leaders of local community groups personally, while the federal government is faceless. Either way, stealing from a local charity may feel to many like stealing from family and friends, while cheating on one's taxes feels more like a victimless offense.[21]

For these reasons, we believe it is important to increase taxpayer awareness of the connection between taxes paid and benefits received. We have recommended that Congress direct the IRS to provide all taxpayers with a "taxpayer receipt" showing how their tax dollars are being spent.[22] This "taxpayer receipt" could be a more detailed version of the pie chart currently published by the IRS,[23] but it should be provided directly to each taxpayer in connection with the filing of a tax return.[24] Better public awareness of the connection between taxes and government spending has the potential to improve civic morale, increase tax compliance, and make the national dialogue over looming fiscal policy choices more productive as well.

20 Russell Research, Inc., *Factors Influencing Compliance: Topline Summary* (May 2012). Russell Research conducted this survey for TAS among a statistically representative sample of sole proprietors. A detailed presentation and analysis of the survey results is published in Volume 2 of this report. *See* Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, vol. 2, *infra*.

21 *See generally* National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2, at 147-150 (Research Study: *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*) (discussing the effect of social norms on tax compliance).

22 *See* National Taxpayer Advocate 2010 Annual Report to Congress 368 (Legislative Recommendation: *Enact Tax Reform Now*).

23 IRC § 7523 requires the IRS to include pie-shaped graphs showing the relative sizes of major outlay categories and major income categories in its instructions for Forms 1040, 1040A, and 1040EZ; *see* IRS Form 1040 Instructions (2011), at 97.

24 In April 2011, the White House website launched a calculator titled "Your Federal Taxpayer Receipt" that allows taxpayers to enter the actual or estimated amounts of their Social Security, Medicare, and income tax payments and to see a breakdown showing how their payments are being applied to major categories of federal spending, including Social Security, Medicare, national defense, health care, job and family security programs, interest on the national debt, Veterans benefits, and education. While we view the availability of this calculator as a positive development, most taxpayers will not take the time to visit this website. We therefore believe a taxpayer receipt should be provided in connection with the filing of a return.

3. The Tax Code Is So Complex That the IRS Has Difficulty Administering It.

The IRS employs some 90,000 full-time workers[25] and performs many of its tasks very well, but it faces daunting challenges in administering the tax code. This report catalogs many of them. Two key indicators of taxpayer service are the IRS's ability to answer taxpayer telephone calls and the IRS's ability to respond to taxpayer correspondence. Despite the fact that about 90 percent of individual taxpayers rely on preparers or tax software packages, the IRS received more than 115 million calls in each of the last two fiscal years.[26] That is a staggering volume of calls, and not surprisingly, the IRS has had trouble answering them. In fact, the problem is growing worse. From FY 2004 to FY 2012, the number of calls the IRS received from taxpayers on its Accounts Management phone lines increased from 71 million to 108 million, yet the number of calls answered by telephone assistors declined from 36 million to 31 million.[27] The IRS has increased its ability to handle taxpayer calls using automation, but even so, the percentage of calls from taxpayers seeking to speak with a telephone assistor that the IRS answered dropped from 87 percent to 68 percent over the period.[28] And among the callers who got through, the average time they spent waiting on hold increased from just over 2½ minutes in FY 2004 to nearly 17 minutes in FY 2012.[29]

Over the same FY 2004 through FY 2012 period, the IRS's ability to timely process taxpayer correspondence also declined. The IRS receives more than ten million letters from taxpayers each year responding to IRS adjustment notices.[30] Comparing the final week of FY 2004 with the final week of FY 20102, the backlog of taxpayer correspondence in the tax adjustments inventory increased by 188 percent (from 357,151 to 1,028,539 pieces), and the percentage of taxpayer correspondence classified as "overage" jumped by 316 percent (from 11.5 percent to 47.8 percent).[31]

As discussed throughout this report, the IRS also struggles to enforce the tax laws, and often burdens taxpayers unnecessarily in attempting to do so.

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25 According to the 2011 IRS Data Book, the IRS ended FY 2011 with about 91,380 full-time equivalent employees – about 3,000 fewer employees than at the end of FY 2010. IRS Data Book, 2011, Table 30, *at* http://www.irs.gov/pub/irs-soi/11databk.pdf. In FY 2012, the IRS budget was reduced by 2.5 percent, which has led to a further reduction in the number of employees. *See* Department of the Treasury, FY 2013 Budget in Brief, *at* http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/11.%20IRS_508%20-%20passed.pdf (showing a decline in enacted appropriations levels from FY 2011 to FY 2012).

26 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (weeks ending Sept. 30, 2011 and Sept. 30, 2012).

27 *Compare* IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2012) *with* IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2004). The Accounts Management phones lines (previously known as the Customer Account Services phone lines) receive the significant majority of taxpayer calls. However, taxpayer calls to compliance phone lines and certain other categories of calls are excluded from this total.

28 *Id*.

29 *Id. See* Most Serious Problem: *The IRS Must Confront Challenges to Delivering Quality Taxpayer Service in the Twenty-First Century, infra*.

30 *See, e.g.*, IRS, Joint Operations Center, *CAS Accounts Management Paper Inventory Reports: FY12 July-September Fiscal Year Comparison*.

31 *Compare* IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 29, 2012) *with* IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2004).

Simply put, tax code complexity strains the IRS's ability to serve taxpayers, while a simpler code would make the job of the tax administrator much easier – something that would benefit taxpayers and the government alike.

B. Tax Simplification Requires Trade-Offs.

There is a widespread belief that the influence of "special interests" is the biggest roadblock to comprehensive tax reform. There is no doubt that many provisions in the tax code benefit narrow groups of taxpayers. But the largest special interests are us — the vast majority of U.S. taxpayers. Virtually all of us benefit from tax breaks that are technically defined as "tax expenditures" — special reductions in tax revenue attributable to an exclusion, exemption, or deduction from gross income or a credit, preferential tax rate, or deferral of tax.[32]

As a preliminary note, we use the term "tax expenditure" rather than "tax loophole" because, in our view, the term "loophole" has taken on a meaning that distorts discussion. In general, taxpayers and policymakers use the term "loophole" to describe a tax expenditure that they do not agree with (or do not benefit from) and use terms like "incentives" or "sound government policy" to describe tax expenditures that they like. To promote a constructive dialogue, we should keep in mind that every provision in the tax code had enough support to pass the House and Senate and be signed into law by the President, and while some provisions benefit broader taxpayer segments than others, every tax break has a constituency. One taxpayer's loophole may be another taxpayer's lifeline, and vice versa. Notably, the significant majority of tax expenditures benefits the masses.

For FY 2013, the Joint Committee on Taxation has estimated that total individual income tax expenditures will come to $1.09 trillion,[33] and the Treasury Department has estimated the total as $1.02 trillion.[34] The following tax expenditures account for 80 percent of this total:[35]

- The exclusion of employer contributions for medical insurance premiums and medical care ($180.6 billion).

32 Congressional Budget and Impoundment Control Act, Pub. L. No. 93-344, § 3(3) (1974). When Congress wishes to spend money, it may do so in either of two ways. It can make expenditures directly via cash outlays, or it can make expenditures by providing tax breaks through the tax code. As a practical matter, a tax expenditure has the same impact as a government spending program. To illustrate, assume that an individual facing a 25 percent tax rate pays $10,000 in mortgage interest and that the government wants to provide a subsidy for home ownership. It could accomplish this objective in two ways: (1) it could allow the taxpayer to deduct the $10,000 of mortgage interest from his gross income, which would produce a tax reduction of $2,500, or (2) it could make a direct payment of $2,500 to the taxpayer in lieu of the tax deduction. The taxpayer ends up in the same economic position either way. For a detailed discussion of tax expenditures, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-119 (*Evaluate the Administration of Tax Expenditures*).

33 Staff of the Joint Committee on Taxation, 112th Cong., *Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015* (Joint Comm. Print 2012), *at* https://www.jct.gov/publications.html?func=select&id=5

34 Office of Management and Budget, Budget of the United States Government, Fiscal Year 2013, Supplemental Materials, Tax Expenditures Spreadsheet, Table 17-2, *at* http://www.whitehouse.gov/omb/budget/Supplemental.

35 This list reflects the Treasury Department's estimates. The Joint Committee on Taxation also publishes a list of tax expenditures. While the aggregate totals are similar, some estimates of specific tax expenditures vary considerably due to differences in methodology.

- The exclusion for retirement plan contributions and earnings ($165.4 billion).[36]
- The mortgage interest deduction for owner-occupied housing ($100.9 billion).
- The reduced rates of tax on long-term capital gains and qualified dividends ($83.9 billion).[37]
- The deduction for nonbusiness state and local taxes ($68.6 billion).
- The exclusion of net imputed rental income ($51.1 billion).
- The deduction for charitable contributions ($46.3 billion).
- The exclusion of Social Security and veterans' benefits ($44.9 billion).[38]
- The exclusion of interest on state and local government bonds ($25.7 billion).
- The exclusion of capital gains at death ($23.9 billion).
- The exclusion of interest on life insurance savings ($22.5 billion).

Other popular benefits include college education tax incentives, notably the exclusion for distributions from Section 529 education savings plans; income exclusions for armed forces personnel; the deduction for medical expenses; child and dependent care credits; tax-favored employee benefits; and the deduction for contributions to Flexible Spending Accounts (both medical and dependent care).

Another perspective: As noted above, the Treasury Department estimates that individual income tax expenditures will total about $1.02 trillion in 2013.[39] As compared with about 140 million individual tax returns,[40] that amounts to an average reduction in tax of more than $7,000 per return.

Because tax is computed as a percentage of income, the total amount of exclusions or deductions that would generate a $7,000 tax reduction is a multiple of the tax reduction. Assume for purposes of illustration that a taxpayer pays a flat tax rate of 25 percent and does not qualify for any tax credits. At a 25-percent tax rate, the average tax reduction of $7,000 would translate to deductions or exclusions from income worth $28,000.

36 This total represents the sum of Section 401(k)-type plans ($72.7 billion), employer plans ($52.3 billion), Individual Retirement Accounts ($19.7 billion), self-employed plans (sometimes known as "Keogh" plans) ($19.6 billion), and the low and moderate income savers credit ($1.1 billion).

37 Of this amount, $62.0 billion is attributable to the reduced rates of tax on capital gains and $21.9 billion is attributable to the reduced rates of tax on qualified dividends.

38 Of this amount, $37.7 billion is attributable to the exclusion of Social Security benefits from income and $7.2 billion is attributable to the exclusion of veterans' benefits from income.

39 *See* Office of Management and Budget, Budget of the United States Government, Fiscal Year 2013, Supplemental Materials, Tax Expenditures Spreadsheet, Table 17-2, *at* http://www.whitehouse.gov/omb/budget/Supplemental.

40 The number of individual income tax returns filed was about 141 million in FY 2010 and about 144 million in FY 2011. *See* IRS Data Book, 2011, Table 2, *at* http://www.irs.gov/pub/irs-soi/11databk.pdf. Complete data for FY 2012 was not available at press time.

Example:

In 2012, a married couple filing a joint federal income tax return received income and benefits totaling $110,000. This included $12,000 of excludible employer-provided health insurance and retirement plan contributions and $16,000 of deductible payments for mortgage interest, state and local taxes, and charitable contributions. (These exclusions and deductions totaled $28,000, which translates to $7,000 in tax expenditures at a 25 percent rate of tax.) The couple received the benefit of two personal exemptions totaling $7,600.[41] Therefore, the couple reduced their $110,000 starting total by $35,600 to arrive at a taxable income of $74,400. Under the 2012 rate tables, the taxpayers end up with a federal tax liability of $10,666. So even though this couple falls into the 25-percent marginal tax rate bracket, they end up paying an average tax rate of less than 10 percent of their aggregate income and excluded benefits.[42]

The list of popular tax expenditures presented above and scenarios such as this one make clear that tax reform is not an easy issue. In concept, most of us agree that the tax code is too complex and that broadening the tax base by eliminating existing tax breaks in exchange for lower rates would improve the system.[43] In practice, the prospect of lower rates may seem speculative and distant, while the threatened loss of existing tax breaks raises immediate concerns. And the lower we want tax rates to be, the more of these tax breaks we have to be willing to give up.

Despite these concerns, the National Taxpayer Advocate believes that fundamental tax reform is essential and urgent. We believe that taxpayers will support tax reform by wide margins if they better understand the trade-offs involved and can be part of an informed dialogue. If tax reform is enacted on a revenue-neutral basis, the average taxpayer's bill will not go up, and taxpayers will be much happier to have a simpler and more transparent system.[44] They will understand how much tax they are paying, they will understand how their tax is computed, and many will save time and money because they no longer will have to pay fees to a preparer to do the job for them.

41 Personal exemptions and the standard deduction are not considered to be tax expenditures because they "defin[e] the zero-rate bracket that is a part of normal tax law." *See* Staff of the Joint Committee on Taxation, 112th Cong., *Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015*, at 5 (Joint Comm. Print 2012). However, they have the effect of reducing taxable income further. If the value of personal exemptions and the standard deduction were considered to be tax expenditures, the Treasury Department's and Joint Committee on Taxation's annual estimates of tax expenditures would be considerably larger.

42 Because tax rates rise with income, these taxpayers pay tax at 10 percent on their first $17,400 of taxable income, at 15 percent on taxable income between $17,400 and $70,700, and at 25 percent on their additional taxable income (under the tax rate tables for 2012).

43 The bipartisan fiscal commission appointed by President Obama in 2010 made recommendations along these lines. *See* National Commission on Fiscal Responsibility and Reform, *A Moment of Truth*, *at* 15, 28-34 (Dec. 2010) at http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform.

44 In the current environment, we understand that Congress may decide to raise revenue in the course of reforming the tax code rather than keep the system revenue-neutral. However, if the choice is between raising a given amount of revenue through increasing tax rates or eliminating tax expenditures, the same structural considerations apply. As discussed in the text above, we advocate tax simplification for the purpose of reducing taxpayer burden. We take no position regarding the broader economic effects of raising or lowering marginal tax rates.

It is important, however, to lay the groundwork for tax reform. Whenever proposals to reduce tax expenditures are made, affected groups and industries often mobilize quickly and seek to build public opposition. Therefore, the taxpaying public must understand that tax reform requires trade-offs between tax rates and tax breaks. An uninformed taxpayer who hears he may lose a tax break will instinctively want to keep it to prevent his tax bill from rising. An informed taxpayer often will have a very different reaction because she understands she will be losing a tax break but probably will not pay more (or at least not much more) because rates will be lowered.[45] The Tax Reform Act of 1986 was the last major revision of the tax code, and despite considerable initial concerns, taxpayers and Members of Congress came around. On the final votes, the Act was supported by significant bipartisan majorities in the House and the Senate.[46]

C. TAS Has Been Receiving Taxpayer Suggestions Through Its Tax Reform Web Page.

To help promote a public dialogue about tax reform, the Office of the Taxpayer Advocate established a web page in January 2011 at www.taxpayeradvocate.irs.gov to solicit taxpayer suggestions. We promised to track and post comments periodically. We asked taxpayers to offer their thoughts on tax reform generally and to consider which tax breaks they would be willing to give up in exchange for simplification of the tax code. To date, we have received more than 3,000 comments. While the comments present a wide range of perspectives and address a variety of issues, most taxpayers seem to understand and support the need for trade-offs.

Here is a sampling of some of the comments:

> "Get rid of all deductions, all special tax rates, all credits, and all special breaks . . . . The process should be so simple no one needs a tax preparer. I am a tax preparer and benefit from the current system, but it is still BAD BAD BAD for the country. It is a massive burden on the economy! I dare you to take away my livelihood! PLEASE!"

> ". . . In order to get a lower tax rate, I would be willing to give up all my itemized deductions and take a standard deduction. Also, I would be willing to give up all my education and 401K and IRA tax breaks if they were included in one overall credit of some lesser amount. For wage earners like myself, you should be able to withhold the right amount of tax so that no return is necessary."

45 In the current environment, we understand that Congress may decide to raise revenue in the course of reforming the tax code rather than keep the system revenue-neutral. However, if the choice is between raising a given amount of revenue through increasing tax rates or eliminating tax expenditures, the same structural considerations apply. As discussed in the text above, we advocate tax simplification for the purpose of reducing taxpayer burden. We take no position regarding the broader economic effects of raising or lowering marginal tax rates.

46 The vote to approve the conference report was 292-136 in the House and 74-23 in the Senate. *See* Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 at 4 (1987).

"I think we need a very simple flat tax that is collected at the source of all income. Eliminate deductions, credits, tax forms, everything. Make a flat percent for all salary income, perhaps a slightly higher percent for interest and dividends and then have it collected directly off of a person's payroll or from the earnings source. This would eliminate the need for record keeping, tax returns, and loopholes. . . ."

"To reduce complexity, eliminate the Alternative Minimum Tax. The goal of the AMT was to prevent wealthy individuals from escaping paying income taxes by using deductions, credits, exclusions, and lower capital gains rates and/or loss offsets to significantly reduce or eliminate their income taxes. This same goal is achievable by either eliminating or phasing out those deductions, exclusions, etc. for the highest income levels. Depending upon the policy goal (for example, revenue neutrality or increased revenue), the highest rates could be lowered or remain the same. . . ."

"My idea of reform is simplicity. To me the fairest tax is a flat tax on gross income. Relative to individual returns, a graduated scale should be employed. Low income, middle class, high net worth individuals. Likewise with business and corporations."

"I would be willing to give up any of the tax breaks that are offered in exchange for a simpler tax code that minimizes the amount of tax paid while still fulfilling the government obligations. If my taxes were to go down in roughly the same amount as the value of my current tax breaks I would not have a problem. . . ."

"Eliminate all 'phase out' provisions. For instance, phase out of [sic] the benefit of itemized deductions, Roth IRA deductions, taxation of Social Security, and (in many years) personal exemptions. All those 'phase out' calculations make understanding the tax process nearly impossible."

"Simplify, simplify, simplify. I'm not necessarily saying flat rate for everybody but eliminate most deductions (both private and corporate) and just lower the tax rate(s). If I pay 15 percent initially but through deductions I only pay 10 percent, why not reduce my rate to say 11 percent? (I support deductions for dependents and charitable giving). The tax code is entirely too complicated, which has spawned a huge community of accountants, tax attorneys, and the IRS."

"I would be willing to give up all credits and reimbursements for a clear, straightforward tax system with lower rates. . . . Taxes reflect a basic conflict between two concepts: 1) A democratic nation is a collective enterprise, and we should all help each other [and] 2) I shouldn't have to pay for some total stranger's benefit. I think that people in general are leaning towards #2 right now. While all tax expenditures have their logic, they often have larger consequences. The mortgage interest deduction doesn't just encourage home ownership; it also encourages purchase of bigger homes. The capital gains rate doesn't just encourage investment, it also encourages speculation. Student loan guarantees don't just encourage access to higher educa-

tion; they also encourage proliferation of for-profit trade schools and pressure to raise tuition at public schools. . . ."

"Policy should be to not use tax codes for social and personal interest policy. It should collect reasonable taxes. My quick suggestions are two that will cost many people including myself: [1] Eliminate open-ended personal deductions. For example, health Insurance premiums may be deducted to an arbitrary and not adjusted amount (for example, $12,000 per year) to encourage but not fully compensate all and any health plans [and] [2] Home mortgage deduction – interest deduction should be capped at not more than $10,000 per year. This encourages home ownership without endlessly rewarding home-related borrowing. . . ."

"I would give up all deductions for a simple rate system for taxes that does not entail anything more than a computer and an online form to complete and e file."

The National Taxpayer Advocate does not necessarily endorse these suggestions, but we have included this selection to provide a sense of what we are hearing from the taxpaying public.[47] At least among members of the public who have taken the time to offer comments, support for tax simplification is strong.

D. Zero-Based Budgeting Approach Could Assist Congress in Deciding Which Tax Breaks and IRS-Administered Social Programs to Retain and Which to Eliminate.

As discussed above, we are well aware that tax reform has become part of the ongoing discussion about ways to reduce the federal budget deficit. However, our longstanding advocacy for fundamental tax reform is aimed at reducing taxpayer burden by simplifying tax compliance and making compliance requirements transparent to taxpayers. For that reason, we recommend that Congress approach tax reform in a manner similar to zero-based budgeting. Under that approach, the starting point would be a tax code without any exclusions or reductions in income or tax. As discussions proceed, tax breaks and IRS-administered social programs would be added only if lawmakers decide on balance that the public policy benefits of running the provision or program through the tax code outweigh the tax complexity challenges that doing so creates for taxpayers and the IRS. Some tax provisions and programs will meet this test, while others will not. Factors to consider in making this assessment include whether the government continues to place a priority on encouraging the activity for which the tax incentive is provided, whether the incentive is accomplishing its intended purpose, and whether a tax expenditure is more effective than a direct expenditure for achieving that purpose.[48] At the end of the process, most taxpayers should be able to complete their returns without the need for a tax preparer, and taxpayers should be able to see clearly how their tax liabilities are derived.

47 Additional comments are posted *at* http://www.taxpayeradvocate.irs.gov//userfiles/file/Tax-Reform-Selected-Comments(1).pdf.

48 *See* National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-119 (*Evaluate the Administration of Tax Expenditures*).

The immediate elimination of certain tax benefits could cause hardships for individuals or businesses where established pricing or conduct is based on those provisions. For example, persons who own homes paid a purchase price that took into account the federal subsidy provided through the mortgage interest deduction. Sudden elimination of that deduction could cause the value of existing homes to drop substantially. If Congress decides to eliminate tax incentives in situations like this, transitional relief should be provided.

In our 2010 Annual Report to Congress, we recommended adoption of a process to evaluate whether a tax expenditure presents an administrative challenge to the IRS or taxpayers and the extent to which it achieves its intended purpose.[49] In our 2009 report, we proposed an analytic framework for evaluating whether specific social benefit programs — whether for individuals or for businesses — should be run through the tax system.[50]

If, in the context of structural tax reform, Congress applies this rigorous analytical framework to all proposed tax expenditures, it will incorporate solely those provisions that fulfill a compelling public policy purpose, that the IRS can effectively administer without undue burden to taxpayers, and that are designed to capture information to evaluate whether the benefit achieves its intended public policy outcome. Importantly, taxpayers and policymakers will understand why such provisions are included in the tax code and will be able to ascertain their effectiveness.

We are not so naïve as to suggest that all tax expenditures will be eliminated, even in the most robust tax reform effort. In fact, there are excellent public policy or administrative reasons for including some programs in the tax code — whether they benefit individuals, small businesses, or entire industries.[51] And we believe that given adequate lead time, proper design, and sufficient resources, the IRS can successfully administer many of these programs without unduly burdening taxpayers or itself.[52] But the tax system will run much

49 *See* National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-119 (*Evaluate the Administration of Tax Expenditures*).

50 National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (*Running Social Programs Through the Tax System*). Among other factors, we suggested that Congress consider the IRS's existing relationship with and access to the targeted population as well as the additional burden imposed on that population, the IRS's ability to deliver the benefit in a timely manner and at the appropriate time, the IRS's access to information necessary to make eligibility determinations, and the IRS's suitability to be the administrator of the provision in light of its enforcement culture. We have also suggested that Congress consider whether the U.S. tax system should remain income-based or should add elements of a consumption tax. *See* National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 35-73 (*An Analysis of Tax Administration Issues Raised by a Consumption Tax, Such as a National Sales Tax or Value Added Tax*). In this analysis, we outlined tax administration challenges that we encourage policymakers to consider if a detailed consumption tax proposal is ultimately developed.

51 For example, the IRS in some cases already has access to all the financial or other data required to determine eligibility for a benefit. If another agency were tasked with administering the benefit, the beneficiary would be required to submit the information twice (once to the IRS and once to another agency) or the IRS would be directed to share confidential tax return information, which would impose administrative burden on two agencies and could undermine future tax compliance.

52 In our 2010 Annual Report to Congress, we recommended that the IRS revise its mission statement to explicitly acknowledge and describe its dual mission of collecting taxes and delivering social benefits. We believe that recognition of the IRS's dual role will help ensure that the IRS is adequately funded to deliver all of its programs and cause it to shift its emphasis from primarily enforcement to providing better service and assistance to its taxpayers and beneficiaries as well. *See* National Taxpayer Advocate 2010 Annual Report to Congress 15-27 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*).

more smoothly if only tax benefits and social programs that withstand this analysis are included in the tax code.

E. Prior National Taxpayer Advocate Recommendations to Simplify Portions of the Tax Code Should Be Considered.

Over the past decade, the Office of the Taxpayer Advocate has made numerous proposals to simplify various sections or areas of the tax code. While these proposals were not written with the goal of structural tax reform in mind, they should be considered as part of an overall tax reform process.

Repeal the Alternative Minimum Tax (AMT) for Individuals.[53] Few people think of having children or living in a high-tax state as a tax-avoidance maneuver, but under the unique logic of the AMT, that is essentially how those actions are treated. The AMT effectively requires taxpayers to compute their taxes twice – once under the regular tax rules and again under the AMT rules – and then to pay the higher of the two amounts. The regular rules allow taxpayers to claim tax deductions for each dependent (recognizing the costs of maintaining a household and raising a family) and for taxes paid to state and local governments (reducing "double taxation" at the federal and state levels), but the AMT rules disallow those deductions. Disallowance of the deductions for state and local taxes and for personal exemptions accounted for about 87 percent of all AMT revenue generated by preference items in 2008.[54] The AMT computations are also extremely burdensome. The National Taxpayer Advocate has recommended that the AMT be repealed. Moreover, we note that if tax expenditures are substantially reduced, the AMT would be rendered largely irrelevant.[55]

Consolidate the Family Status Provisions. Notwithstanding the improvements brought about by enactment of a Uniform Definition of a Child in 2004, the tax code's family status provisions continue to ensnare taxpayers and make tax administration difficult simply because of the number of such provisions and their structural interaction. These provisions include filing status, personal and dependency exemptions, the child tax credit, the EITC, the child and dependent care credit, and the separated spouse rule under IRC § 7703(b). Many of the eligibility requirements — such as support or maintenance costs

53 The AMT is discussed in more detail later in this report. *See* Most Serious Problem: *The Alternative Minimum Tax Corrodes Both the Tax System and the Democratic Process*, *infra*.

54 *See* Tax Policy Center, *AMT Preference Items 2002, 2004-2008* (Dec. 21, 2010), *at* http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=468&Topic2id=30&Topic3id=36.

55 The National Taxpayer Advocate has repeatedly identified the AMT as a serious problem for taxpayers and has recommended its repeal in prior reports and congressional testimony since 2001. *See* National Taxpayer Advocate 2008 Annual Report to Congress 356-362 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2006 Annual Report to Congress 3-5 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2004 Annual Report to Congress 383-385 (Legislative Recommendation: *Alternative Minimum Tax*); National Taxpayer Advocate 2003 Annual Report to Congress 5-19 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2001 Annual Report to Congress 166-177 (Legislative Recommendation: *Alternative Minimum Tax for Individuals*); *see also Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means* (March 7, 2007) (statement of Nina E. Olson, National Taxpayer Advocate); *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance* (May 23, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).

of the home — are difficult for the IRS to verify without conducting audits into taxpayers' personal and private lives. The National Taxpayer Advocate has recommended that, as part of a comprehensive reform of the tax code's tax treatment of families, Congress consolidate the numerous existing family status-related provisions into two categories: (1) a Family Credit and (2) a Worker Credit. The refundable Family Credit would reflect the costs of maintaining a household and raising a family, while the refundable Worker Credit would provide an incentive and subsidy for low income individuals to work.[56]

Improve Other Provisions Relating to Taxation of the Family Unit. The tax code currently imposes "joint and several liability" on married persons who file a joint federal income tax return. This concept dates back to the early years of the income tax when a husband was typically the sole wage earner for the family unit. Today, husbands and wives often have separate assets and incomes that they do not equally control. Recognizing that it is inequitable to hold one spouse liable for tax on the other spouse's income, at least in cases where he or she does not know about the income of the other spouse and does not significantly benefit from it, Congress has enacted relief rules. However, these relief rules are complex, do not always produce the right result, and impose a large burden on the "innocent spouse" to prove his or her case. The National Taxpayer Advocate has recommended several steps to improve equity and simplify the rules, including eliminating joint and several liability for joint filers.[57]

The "kiddie tax" rules are another family-related area of taxation that create significant burden for some taxpayers. The tax code currently taxes a minor child's unearned income above a certain threshold at the parent's tax rate. The parent must decide whether to file a separate return for the child or include the child's income on the parent's own return. The calculations required to determine which option is preferable in a particular case are complex. Moreover, if the child's parents are separated, additional complications arise. If a custodial parent has been designated, the child's income must be included on that parent's return. If no custodial parent has been designated, the law requires the tax to be computed by reference to the return of the parent with the greater taxable income. During a divorce proceeding, however, spouses sometimes conceal their assets or income from the other spouse, making compliance with these rules impractical. The National Taxpayer Advocate has recommended that the unearned income of minor children above a specified threshold be taxed at a higher rate and that the link between the computation of the child's tax liability and the parent's tax return be severed.[58]

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56 *See* Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children, infra*, and Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to Be Considered "Not Married," infra; see also* National Taxpayer Advocate 2008 Annual Report to Congress 363-369 (Legislative Recommendation: *Simplify the Family Status Provisions*); National Taxpayer Advocate 2005 Annual Report to Congress 397-406 (Legislative Recommendation: *Tax Reform for Families: A Common Sense Approach*).

57 *See* National Taxpayer Advocate 2005 Annual Report to Congress 407-432 (Legislative Recommendation: *Another Marriage Penalty: Taxing the Wrong Spouse*); *see also* National Taxpayer Advocate 2001 Annual Report to Congress 128-165 (Legislative Recommendation: *Joint and Several Liability*).

58 *See* National Taxpayer Advocate 2002 Annual Report to Congress 231-242 (Legislative Recommendation: *Children's Income*).

Consolidate Education Savings Tax Incentives. The tax code contains at least 11 separate incentives to encourage taxpayers to save for and spend on education. The eligibility requirements, definitions of common terms, income-level thresholds, phase-out ranges, and inflation adjustments vary from provision to provision. The point of a tax incentive, almost by definition, is to encourage certain types of economic behavior. However, taxpayers will only respond to incentives if they know they exist and understand them. Few, if any, taxpayers are aware of each of the education tax incentives and familiar enough with the particulars to make wise choices. The National Taxpayer Advocate has recommended that Congress consolidate incentives and harmonize definitions and other terms to the extent possible.[59]

Consolidate Retirement Savings Tax Incentives. The tax code contains at least 16 separate incentives to encourage taxpayers to save for retirement. These incentives are subject to different sets of rules governing eligibility, contribution limits, taxation of contributions and distributions, withdrawals, availability of loans, and portability. Similar to education savings incentives, the large number of retirement savings options and the lack of common definitions and terms can preclude taxpayers from making wise choices or understanding how each incentive works. The National Taxpayer Advocate has recommended that Congress consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement savings option for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.[60]

Simplify Worker Classification Determinations to Minimize Employee-versus-Independent Contractor Disputes. The complexity and ambiguities in the existing worker classification rules create uncertainty for businesses and workers and lead to noncompliance. In general, businesses are required to pay and withhold employment tax, withhold income tax, and provide benefits only with respect to employees. Consequently, businesses have an incentive to classify workers as independent contractors to reduce their costs. Some workers seeking to avoid their tax obligations may also prefer to be classified as contractors if the business does not withhold taxes or report the payments to the IRS. Whether a worker should be classified as an employee or an independent contractor depends on a variety of factors that reflect the nature of the relationship between the worker and the business. The National Taxpayer Advocate has recommended that Congress:

59 *See* National Taxpayer Advocate 2008 Annual Report to Congress 370-372 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 403-422 (Legislative Recommendation: *Simplification of Provisions to Encourage Education*).

60 *See* National Taxpayer Advocate 2008 Annual Report to Congress 373-374 (Legislative Recommendation: *Simplify and Streamline Retirement Savings Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 423-432 (Legislative Recommendation: *Simplification of Provisions to Encourage Retirement Savings*).

1) Replace § 530 of the Revenue Act of 1978 with a provision applicable to both employment and income taxes, and require that the IRS consult with affected industries and report back to the tax-writing committees on the findings of its consultations, with the ultimate goal that the Secretary issue guidance based on these findings, including guidance with specific industry focus;[61]
2) Direct the IRS to develop an electronic tool to determine worker classifications that employers would be entitled to use and rely upon, absent misrepresentation;
3) Allow both employers and employees to request classification determinations and seek recourse in the United States Tax Court; and
4) Direct the IRS to conduct outreach and education campaigns to increase awareness of the rules as well as the consequences associated with worker classification.[62]

Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets. The tax code contains more than 100 provisions that expired at the end of 2011 or were set to expire at end of the 2012,[63] up from about 21 in 1992. Tax benefits have increasingly been enacted for a limited number of years to reduce their cost for budget-scoring purposes. However, tax sunsets make it difficult for both the government and taxpayers to plan, especially when it is uncertain whether Congress will extend a provision that is set to expire. The complexity and uncertainty caused by sunsets make it more difficult for taxpayers to estimate liabilities and pay the correct amount of estimated taxes, complicate tax administration for the IRS, reduce the effectiveness of tax incentives, and may even reduce tax compliance. The National Taxpayer Advocate has suggested several ways for Congress to reduce or eliminate the procedural incentives to enact temporary tax provisions.[64]

Eliminate (or Simplify) Phase-Outs. Roughly half of all individual income tax returns filed each year are affected by the phase-out of certain tax benefits as a taxpayer's income increases. There are, in fact, legitimate policy reasons for using phase-outs in certain circumstances. Like tax sunsets, however, phase-outs are largely used to reduce the cost of tax provisions for budget-scoring purposes. Moreover, phase-outs are burdensome for taxpayers, reduce the effectiveness of tax incentives, and make it more difficult for taxpayers to estimate their tax liabilities and pay the correct amount of withholding or estimated taxes, possibly reducing tax compliance. Phase-outs also create marginal "rate bubbles" — income ranges within which an additional dollar of income earned by a relatively low income taxpayer is taxed at a higher rate than an additional dollar of income earned by a relatively

61 Our initial recommendation was simply to require that the Secretary issue guidance. Based on subsequent discussions with small business groups, we revised our recommendation to suggest that Congress first direct the IRS to hold a series of consultations with affected industries and report back to the tax-writing committees on its findings.

62 *See* National Taxpayer Advocate 2008 Annual Report to Congress 375-390 (Legislative Recommendation: *Worker Classification*).

63 *See* Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2011-2022*, JCX-1-12 (Jan. 6, 2012), *at* https://www.jct.gov/publications.html?func=startdown&id=4383.

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

high income taxpayer. Because Congress could achieve a similar distribution of the tax burden based on income level by adjusting marginal rates, phase-outs introduce unnecessary complexity to the Code. The National Taxpayer Advocate has recommended that Congress repeal phase-outs or at least reassess them individually to ensure that they are necessary to accomplish their intended objective.[65]

Streamline the Penalty Regime. The number of civil tax penalties has increased from about 14 in 1954 to more than 130 today. The last comprehensive reform of the tax code's penalty provisions was enacted in 1989, after careful study by Congress, the IRS, and others. Since then, legislative and administrative changes to the penalty regime have proceeded piecemeal, but without the kind of careful analysis conducted in 1989. The National Taxpayer Advocate has recommended that Congress direct the IRS to (1) collect and analyze more detailed penalty data on a regular basis and (2) conduct an empirical study to quantify the effect of each penalty on voluntary compliance. Congress should appropriate additional funds for this research, as necessary. In the meantime, based on penalty reform principles identified in 1989, the National Taxpayer Advocate has recommended 11 steps that could be taken immediately.[66]

F. While Corporate Tax Reform Is Needed, Individual Income Tax Reform Should Be Given Priority.

The tax reform recommendations in this report focus on the individual income tax regime. This is for two reasons. First, there are vastly more taxpayers who file individual income tax returns. Second, even among businesses, most conduct their operations as sole proprietors or through "pass-through" entities and ultimately report their business income on their individual income tax returns.

Specifically, there were over 140 million individual tax returns filed in FY 2011.[67] There were also more than 32 million pass-through businesses, including at least 22.3 million sole proprietors that filed Schedules C,[68] at least 1.9 million farmers that filed Schedules F,[69] 4.5 million S corporations that filed Forms 1120-S,[70] and 3.6 million partnerships that filed Forms 1065.[71] By contrast, only 2.3 million C corporations are taxed at the entity level and would derive most of the direct benefits of corporate tax reform.[72] This is not to minimize

65 *See id*. at 410-413 (Legislative Recommendation: *Eliminate (or Simplify) Phase-outs*).

66 *See id*. at 414-418 (Legislative Recommendation: *Reforming the Penalty Regime*), and vol. 2, Research Study: *A Framework for Reforming the Penalty Regime*.

67 *See* IRS Data Book, 2011, Table 2, *at* http://www.irs.gov/pub/irs-soi/11databk.pdf.

68 IRS Compliance Data Warehouse, Individual Returns Transaction File (Fiscal Year 2011). This figure reflects the number of Form 1040-series returns that contained at least one Schedule C. Some returns contained more than one Schedule C, so the total number of sole proprietorships was somewhat greater than 22.3 million.

69 *Id*. This figure reflects the number of Form 1040-series returns that contained at least one Schedule F. Some returns contained more than one Schedule F, so the total number of unincorporated farming businesses was somewhat greater than 1.9 million.

70 IRS Data Book, 2011, Table 2, *at* http://www.irs.gov/pub/irs-soi/11databk.pdf.

71 *Id*.

72 *Id*.

the need for corporate tax reform, and the rationale for curtailing tax benefits in exchange for lower rates applies in that context as well. We are simply saying that corporate tax reform will not eliminate any of the complexity or burden that the vast majority of U.S. taxpayers experience today.

CONCLUSION

For all the reasons described above, we believe that fundamental reform must be made a priority. A simpler, more transparent tax code will substantially reduce the estimated 6.1 billion hours and $168 billion that taxpayers spend on return preparation; reduce the likelihood that sophisticated taxpayers can exploit arcane provisions to avoid paying their fair share of tax; enable taxpayers to understand how their tax liabilities are computed and prepare their own returns; improve taxpayer morale and tax compliance — including the level of connection that taxpayers feel with the government; and enable the IRS to administer the tax system more effectively and better meet taxpayer needs.

Based on all the comments we receive every year in the Taxpayer Advocate Service and our experience in handling hundreds of thousands of taxpayer cases a year, we believe that lowering rates in exchange for broadening the tax base would be an excellent bargain. We are confident that in the end, public support for a simpler code will be strong and deep.

Recommendations

The National Taxpayer Advocate recommends that Members of Congress take the following steps:

1. Consider holding meetings with constituents to discuss both the complexity of the existing tax code and the trade-offs between tax rates and tax breaks that tax reform will require. In our view, it is critical to lay this groundwork for tax reform to succeed. The evolution of the Tax Reform Act of 1986 suggests that taxpayers will initially be concerned about losing tax benefits but will ultimately support tax simplification if and when they feel confident that the loss of tax benefits will be substantially offset by a reduction in tax rates.
2. Employ a "zero-based budgeting" approach to comprehensive tax reform that starts out with the assumption that all tax benefits will be eliminated and adds tax benefits back only if Members conclude that the public policy benefits of running the provision or program through the tax code outweigh the tax complexity that doing so creates for taxpayers and the IRS. We are concerned that if Members do not follow this approach, the final outcome will reflect more tinkering around the margins than fundamental tax simplification.
3. Consider some of the specific recommendations we have made in the past and summarized in this section — not as a substitute for comprehensive reform but as a checklist to ensure that these important issues are addressed.
4. Solicit suggestions and comments from the IRS regarding the administrability of tax reform provisions under consideration. Proposals that make theoretical sense must be practical for the IRS to translate into forms and instructions and must be enforceable.
5. Solicit suggestions and comments from the National Taxpayer Advocate regarding the taxpayer burden and taxpayer rights impact of tax reform provisions under consideration. Conceptually sound proposals should be tested to ensure they are comprehensible to taxpayers, easy to comply with, and administrable by the IRS without undue burden or harm to taxpayers.
6. Amend Section 7523 of the Internal Revenue Code to direct the IRS to provide each taxpayer with a "Taxpayer Receipt" in conjunction with the filing of a tax return that shows how the taxpayer's tax payments will be spent. For the reasons discussed above, we believe public trust in Congress and the government will be enhanced if taxpayers see more clearly the connection between the taxes they pay and the benefits they receive.

MSP #2 The Alternative Minimum Tax Corrodes Both the Tax System and the Democratic Process

DEFINITION OF PROBLEM

The individual Alternative Minimum Tax (AMT) was originally enacted to ensure wealthy persons paid at least some tax.[1] Because the AMT is not indexed for inflation, limited to high income taxpayers, or focused on tax loopholes, however, it increasingly penalizes middle income taxpayers for having children, getting married, or paying state and local taxes while allowing thousands of millionaires to pay no tax at all.[2]

The AMT is complicated and burdensome, even for those who are not subject to it. Many taxpayers must fill out the lengthy AMT form only to find they owe little or no AMT after all. Others must complete the form just to claim certain tax credits. The AMT requires taxpayers to compute their taxes twice — once under the regular tax rules and again under the AMT rules. If the "tentative minimum tax" (or tentative AMT) liability exceeds the regular tax liability, the taxpayer pays the difference as AMT. Thus, the AMT reduces the transparency of the tax system, making it more difficult for nearly everyone to predict what they will owe.

As if the AMT were not complicated enough, Congress regularly passes so-called AMT "patches" to temporarily protect middle-class taxpayers and popular tax benefits, typically at the last minute or on a retroactive basis.[3] Last-minute patches sometimes delay urgently needed tax refunds because with every change in law the IRS has to update its systems before processing returns. Because IRS systems assume a patch will be enacted in 2012, if Congress does not enact a patch, as expected, return processing will be delayed for 80 to 100 million taxpayers - more than half of all filers - and about 33 million taxpayers

1 S. Rept. No. 97-494 vol. 1, at 108 (1982).

2 TPC, T12-0171, *Characteristics of AMT Taxpayers With and Without AMT Patch, 2011-2013*, 2022 (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3514; TPC, T11-0175, *Distribution of Tax Units that Pay No Individual Income Tax by Cash Income Level, Current Law, 2011* (July 13, 2011), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3056 (number of millionaires). The National Taxpayer Advocate has repeatedly identified the AMT as a serious problem for taxpayers and has recommended its repeal in prior reports and congressional testimony. *See, e.g.*, National Taxpayer Advocate 2001 Annual Report to Congress 56-58; National Taxpayer Advocate 2001 Annual Report to Congress 166-177; National Taxpayer Advocate 2003 Annual Report to Congress 5-19; National Taxpayer Advocate 2004 Annual Report to Congress 383-385; *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance* (May 23, 2005) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2006 Annual Report to Congress 3-5; *Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means* (Mar. 7, 2007) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2008 Annual Report to Congress 356-362.

3 In 2012, if Congress does not enact another retroactive patch, by one estimate 31 million taxpayers will pay $118 billion in AMT. *See* Joint Committee on Taxation (JCT), JCX-18-12, *Overview of the Federal Tax System as in Effect for 2012* 29-30, fig. A-5 and fig. A-6 (Feb. 24, 2012), https://www.jct.gov/publications.html?func=startdown&id=4400. This projection is similar to the TPC projections that we cite throughout this report. TPC estimates 34.9 million taxpayers will pay $119.8 billion. TPC, T12-0169, *Baseline AMT Projections, Aggregate AMT Projections, 2011-2022* (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3512. The IRS estimates that about 33 million taxpayers could pay AMT. See Letter from Acting IRS Commissioner to Ranking Member, House Committee on Ways and Means (Nov. 13, 2012),http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/Final_Response_Levin_37392.pdf.

could pay AMT.[4] Many taxpayers will also face estimated tax shortfalls and underpayment penalties.

The AMT is difficult to repeal because it is projected to raise a large amount of revenue. However, AMT patches have always prevented the AMT from raising these projected amounts. What we have, in essence, is one law that grants popular tax benefits (the regular tax code), another law that eliminates the benefits (the AMT), and then yet a third law that undoes the elimination of benefits (the patches), usually at the last minute — a legislative Rube Goldberg contraption of unnecessary complexity.

In addition, the AMT reduces the transparency of the tax reform debate. For example, anyone proposing a tax cut has to determine whether the AMT will recapture the cut, and if so, whether to allow the cut to appear deceptively inexpensive because the AMT claws it back or to propose additional and costly changes to mitigate the AMT. Further, any revenue estimate for a tax reform proposal will have to be compared to the illusory revenue that supposedly will be collected after expiration of the AMT patch under current law — even though no one believes Congress will let the patch expire. In this way, the AMT corrodes both the tax system and the democratic process.

ANALYSIS OF PROBLEM

The AMT does not achieve its original goal.

Congress enacted a minimum tax (the predecessor of today's Alternative Minimum Tax or "AMT") after hearing testimony that 155 taxpayers with adjusted gross incomes (AGI) above $200,000 (about $1,427,882 in 2012 dollars)[5] paid no federal income tax for the 1966 tax year, due to tax preferences or loopholes.[6] Remarkably, the AMT today does not achieve its original goal of ensuring that all wealthy persons pay income tax. In 2009 (the most recent year for which complete data is available), nearly 21,000 taxpayers with adjusted gross incomes (AGI) of more than $200,000 paid no income tax at all — over 35,000 taxpayers if you use a more expanded definition of income than AGI.[7]

Perhaps more remarkably, the AMT will soon hit a much higher percentage of middle income and upper-middle income taxpayers than wealthy taxpayers. In 2013, absent another patch, the AMT is projected to affect an estimated 33 percent of taxpayers with

4 *See id;* Letter from Acting IRS Commissioner to Chairman, House Committee on Ways and Means (Dec. 19, 2012), http://waysandmeans.house.gov/uploadedfiles/camp_12_19_12.pdf.

5 *See* Bureau of Labor Statistics, *CPI Inflation Calculator, available at* http://www.bls.gov/data/inflation_calculator.htm (last visited Nov. 29, 2012).

6 The 1969 Economic Report of the President: Hearings before the Joint Economic Comm., 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury).

7 Justin Bryan, *High-Income Tax Returns for 2009*, 31 SOI Bulletin 6, 11 fig. C (Spring 2012), http://www.irs.gov/pub/irs-soi/12soisprbul.pdf.

incomes between $75,000 and $100,000 and 44 percent of taxpayers with incomes between $100,000 and $200,000 — yet only 14 percent of taxpayers with incomes above $1 million.[8]

The AMT hits middle-income taxpayers for getting married, having children, and paying state and local taxes.

Because the AMT exemption amount is not indexed for inflation, and the AMT is not limited to high income taxpayers, or focused on loopholes, it increasingly hits taxpayers who have not done any tax planning. This is largely because the AMT eliminates the tax "benefit" of children (dependency exemptions are lost under the AMT) and marriage (the AMT contains marriage penalties), and does not allow a deduction for state and local taxes.[9] As a result, 84 percent of married couples with two or more children and adjusted gross income between $75,000 and $100,000 will be hit by the AMT in 2012, up from 0.2 percent in 2011, unless Congress enacts retroactive legislation.[10] While it is hard to imagine that the drafters of the original AMT provision would view incurring expenses to raise a family or living in a high-tax state as a tax-avoidance loophole, that is essentially the way those expenses are viewed under today's AMT.

More than 35,000 taxpayers with incomes above $200,000 pay no income tax despite the AMT.

More than 35,000 taxpayers with incomes of more than $200,000 paid no income tax in 2009, and one projection estimated that about 7,000 millionaires reportedly paid no income tax in 2011.[11] One reason for this is the exclusion of interest on certain tax-exempt bonds (and certain miscellaneous itemized deductions) under both regular tax and the AMT.[12] For example, wealthy individuals who invest in certain tax exempt municipal bonds generally pay no federal income tax on the interest they receive.

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8 TPC, T12-0171, *Characteristics of AMT Taxpayers With and Without AMT Patch, 2011-2013*, 2022 (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3514 (2012 current law).

9 Disallowance of the deduction for state and local taxes accounted for about 68 percent of all of the AMT revenue generated by preference items in 2008. *See* TPC, *AMT Preference Items 2002, 2004-2008* (Dec. 21, 2010), http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=468&Topic2id=30&Topic3id=36.

10 TPC, T12-0171, *Characteristics of AMT Taxpayers With and Without AMT Patch, 2011-2013*, 2022 (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3514.

11 Justin Bryan, *High-Income Tax Returns for 2009*, 31 SOI Bulletin 6, 14 (Spring 2012), http://www.irs.gov/pub/irs-soi/12soisprbul.pdf ("20,752 returns with no U.S. income tax had an AGI of $200,000 or more; 35,061 returns with no U.S. income tax had an expanded income of $200,000 or more; and 16,465 returns with no U.S. income tax had both AGI and expanded income of $200,000 or more"); TPC, T11-0175, *Distribution of Tax Units that Pay No Individual Income Tax by Cash Income Level, Current Law, 2011* (July 13, 2011), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3056 (number of millionaires). Of course, more taxpayers would pay no tax without the AMT – at least 7,600 high income filers by one 2005 estimate. *See* Leonard E. Burman, William G. Gale and Jeffrey Rohaly, *The Expanding Reach of the Individual Alternative Minimum Tax* 7 (May 2005), http://www.taxpolicycenter.org/publications/url.cfm?ID=411194.

12 Justin Bryan, *High-Income Tax Returns for 2009*, 31 SOI Bulletin 6, 15-17 (Spring 2012), http://www.irs.gov/pub/irs-soi/12soisprbul.pdf ("nontaxable returns under the expanded income concept, were much more likely to have tax-exempt interest than were taxable returns.... Similarly, nontaxable returns were much less likely to have any income from salaries and wages.... Because they do not generate AMT adjustments or preferences, tax-exempt bond interest, itemized deductions for interest expense, miscellaneous itemized deductions not subject to the 2-percent-of-AGI floor, casualty or theft losses, and medical expenses (exceeding 10 percent of AGI) could, by themselves, produce nontaxability."); Derek Thompson, *Buffett Rule Rorschach: 7,000 Millionaires Paid No Income Taxes in 2011*, The Atlantic (Sept. 21, 2011), http://www.theatlantic.com/business/archive/2011/09/buffett-rule-rorschach-7-000-millionaires-paid-no-income-taxes-in-2011/245469/ (indicating that items such as tax exempt bonds and casualty losses account for the zero liability returns, citing Roberton Williams of the TPC).

High income investors face lower marginal rates than moderate income wage earners despite the AMT because the AMT applies preferentially low rates to investment income.

High income taxpayers can pay lower rates than moderate income taxpayers because preferential low rates apply to investment income under both the regular tax system and the AMT. In general, the AMT regime taxes upper-income taxpayers at a flat rate of 28 percent.[13] Before 1997, capital gains were considered a preference item and taxed at the same flat rate as other AMT income.[14] Under current law, however, long-term capital gains and qualified dividend income are subject to a special low rate, which is generally 15 percent, under both the regular tax and the AMT.[15] Therefore, taxpayers who have sufficient resources to live off investment income pay tax at 15 percent (or perhaps less if they have tax-exempt bond income) — less than the 25 percent marginal rate applicable to a single person who earns just $34,501 in taxable income from wages.[16]

The AMT is complicated and burdensome.

Although the IRS has not measured the compliance costs arising from the AMT, it has estimated that taxpayers spent over 18 million hours in 2000 completing and filing AMT tax forms or determining whether they needed to do so — more than 12 hours for each person who actually paid the AMT.[17] By comparison, the IRS estimates that it takes 22 hours, on average, to fill out the entire Form 1040, *U.S. Individual Income Tax Return*.[18]

Tax software and preparers can reduce but not eliminate the burden of the AMT.

While computer software and tax preparers can reduce the complexity of computing the AMT, significant burdens remain. For example, the amount of state and local tax refunds included in income depends on the extent to which the AMT limited the state and local tax deductions in the prior year. That amount often needs to be calculated manually because it requires the taxpayer to recalculate his or her prior-year income tax liability.

13 The 28 percent rate applies after a phase-out of the exemption amount and a 26 percent rate that applies to the first $175,000 of income. *See generally* IRC § 55.

14 Taxpayer Relief Act of 1997, Pub. L. 105-34, § 311(b), 111 Stat. 788 (1997) (reducing the rate applicable to long-term capital gains under both the regular tax system and the AMT).

15 Middle-income taxpayers who benefit from the AMT exemption face a higher marginal tax rate on long-term capital gains and dividend income because it decreases the value of the AMT exemption. *See, e.g.*, Benjamin H. Harris and Christopher Geissler, *Tax Rates on Capital Gains and Dividends Under the AMT*, 118 Tax Notes 1031 (Mar. 3, 2008). An IRS analysis of the 400 taxpayers reporting the highest income found that between year 2000 and 2009, 46 to 72 percent of the income they reported was from capital gains. *See* IRS, SOI, *The 400 Individual Income Tax Returns Reporting the Largest Adjusted Gross Incomes Each Year, 1992-2009* (2009), http://www.irs.gov/pub/irs-soi/09intop400.pdf.

16 IRC § 1; Instructions for IRS Form 1040, *U.S. Individual Income Tax Return* 98 (2011).

17 Allen H. Lerman and Peter S. Lee, *Evaluating the Ability of the Individual Taxpayer Burden Model To Measure Components of Taxpayer Burden: The Alternative Minimum Tax as a Case Study*, 2004 IRS Research Conference 140, 151, 166 (Feb. 2005), http://www.irs.gov/uac/SOI-Tax-Stats---Papers---2004-IRS-Research-Conference (estimating the AMT added 18.4 million hours in burden (including burden for those who did not owe AMT), and that between 1.4 and 1.5 million taxpayers actually paid AMT or had a reduced credit in tax year (TY) 2000).

18 Instructions for Form 1040, *U.S. Individual Income Tax Return* 95 (2011).

One study found that between 62 and 67 percent of the Forms 6251, *Alternative Minimum Tax – Individuals*, received by the IRS in TY 2000 were unnecessary.[19] Given the prevalent use of tax preparation software and tax preparers, this data suggests that such preparation aids do not always ease the complexity and burden of the AMT, even for taxpayers who are not subject to it. Moreover, this burden is growing as increasing numbers of taxpayers fall under the AMT regime — or at least believe they do.

The AMT hides the true cost of tax cuts, as estimates of AMT revenue have proven illusory.

The AMT replaces personal exemptions and some deductions (including the standard deduction and the deduction for state and local taxes)[20] with an AMT exemption, and then applies its own rate schedule, which contains a marriage penalty. It may also limit the use of personal credits.[21]

In this way, the AMT reclaims tax cuts and preferences enacted under the regular tax system, stealthily reducing their apparent cost. As a result, the AMT is projected to raise an enormous amount of revenue — about $1.2 trillion from 2011-2022 ($2.3 trillion if the 2001-2003 tax cuts are extended) according to one estimate, at least on paper.[22]

In reality, the AMT is projected to have raised only about $33 billion in each of the last two years (2010 and 2011), which is the most it has ever raised.[23] It does not meet revenue projections because Congress has repeatedly enacted short-term "patches" — eight since 2001 — to increase the AMT exemption amounts, sometimes on a retroactive basis.[24]

19 See Allen Lerman and Peter Lee, *Evaluating the Ability of the Individual Taxpayer Burden Model to Measure Components of Taxpayer Burden: The Alternative Minimum Tax as a Case Study*, 2004 IRS Research Conference 140, 151 fig. 5 (Feb. 2005), http://www.irs.gov/pub/irs-soi/04lerman.pdf (showing three different estimates for TY 2000 filings: 3.786 million / 5.657 million (or 67 percent), 3.104 million / 5.034 million (or 62 percent), and 2.923 million / 4.724 million (or 62 percent)). A study of TY 2000 returns indicated that 3.8 million taxpayers spent $331.8 million to file Form 6251 when it was not needed. *Id*. at 155 fig. 6, 162 fig.11.

20 The disallowance of these items accounted for 87 percent of all AMT revenue in 2008. TPC, *AMT Preference Items 2002, 2004-2008* (Dec. 21, 2010), http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=468&Topic2id=30&Topic3id=36.

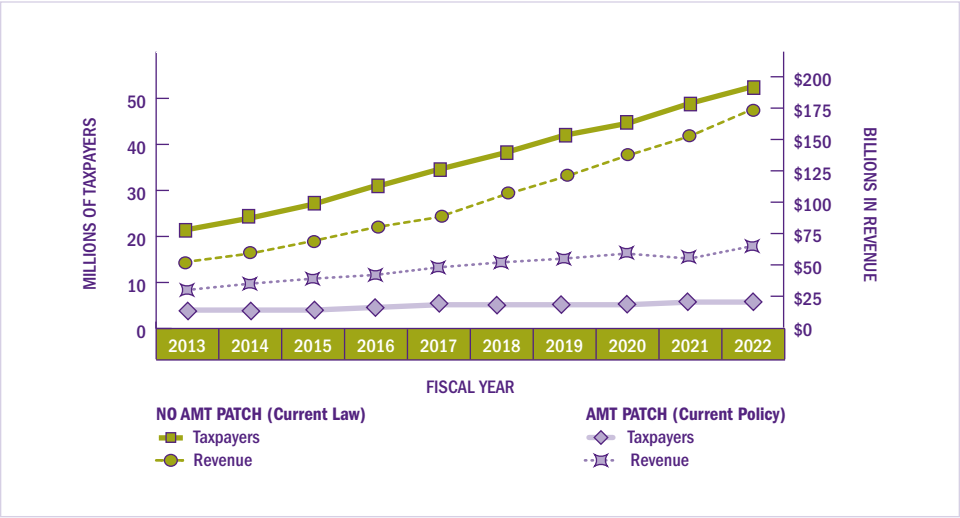
21 For taxable years after 1999, nonrefundable personal credits generally may not offset the AMT. IRC §26(a)(1). However, for taxable years beginning in 2000 through 2011, nonrefundable personal credits are allowed to offset both regular tax liability and AMT liability. IRC §26(a)(2). Thus, the AMT could limit personal credits if they are not addressed in subsequent legislation.

22 TPC, T12-0169, *Baseline AMT Projections; Current Law and Current Policy, 2011-2022* (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3512.

23 TPC, T12-0168, *Aggregate AMT Projections and Recent History, 1970-2022*, (June 3, 2011), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3511&DocTypeID=7.

24 For a list of AMT patches, see, *e.g.*, TPC, *Historical AMT Legislation*, (Jan. 31, 2011), http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=195&Topic2id=30&Topic3id=36.

FIGURE 1.2.1, Projections of AMT Revenues and Taxpayers Affected by AMT with and without an AMT Patch[25]



The AMT significantly alters long-term federal deficit projections. More than half of the $1 trillion projected to be generated by the AMT over the next ten years (under current law) will not be collected if AMT patches continue to be enacted, which is likely to be the case absent fundamental tax reform.[26]

Temporary AMT patches prompt late-year and retroactive tax law changes.

AMT patches are necessary to keep middle class taxpayers from being hit by the AMT. In 2012, if Congress does not enact another retroactive patch, 46 percent of all tax filers with income between $75,000 and $100,000 will pay the AMT, as will 97 percent of those with income between $200,000 and $500,000.[27] Yet, only 37 percent of millionaires will pay the AMT, as shown in the following chart.[28]

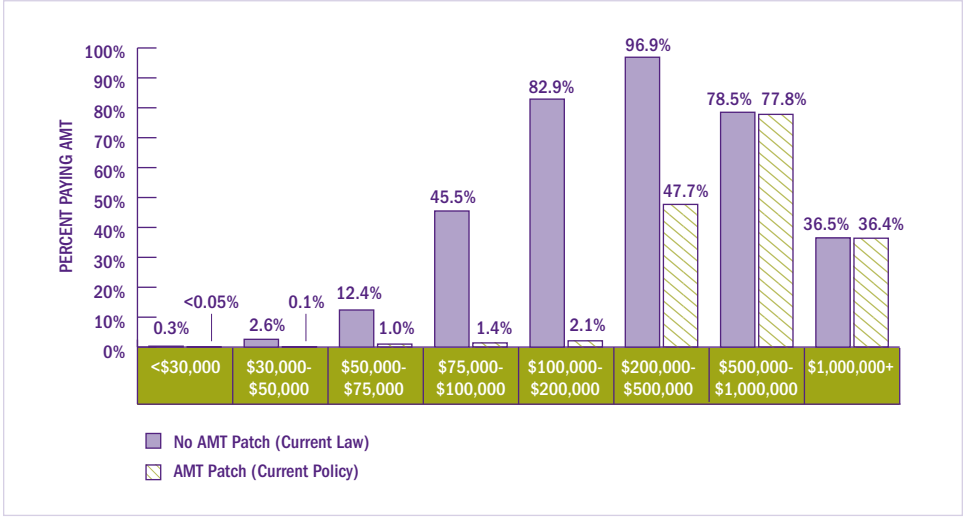
25 TPC, *Aggregate AMT Projections and Recent History, 1970-2022*, (June 3, 2011), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3511&DocTypeID=7. The revenue estimates include revenue from direct AMT liability on Form 6251, lost credits, and reduced deductions. *Id*. The estimates of the number of taxpayers affected by the AMT include those affected by each of these items. *Id*. They assume that if an AMT patch is enacted for 2012, all the temporary provisions in place for calendar year 2011 are also extended, with the exception of the payroll tax cut. They also assume the AMT patch sets exemption levels to those specified in Senate bill S.3413 for 2012 and 2013, indexes the 2013 levels in later years, and allows non-refundable personal credits against AMT liability. Senate bill S. 3413 sets the AMT exemption amount for 2012 at $50,600 for individuals and $78,750 for married taxpayers filing jointly and for 2013 at $51,150 for individuals and $79,850 for married taxpayers filing jointly. S. 3413, 112th Cong. (2012).

26 TPC, *Aggregate AMT Projections and Recent History, 1970-2022* (June 3, 2011). JCT recently estimated that it would cost about $855 billion over 10 years to enact the President's proposal to make the 2011 exemption amounts permanent, index them for inflation, index the 28 percent AMT bracket, and remove certain personal credits from the AMT. Congressional Budget Office (CBO), *An Analysis of the President's 2013 Budget* 7 (Mar. 2012), http://www.cbo.gov/publication/43083 (citing a JCT estimate). A recent proposal to extend the AMT patch for 2010 and 2011 was estimated to cost about $136.7 billion if the Bush-era tax cuts were also extended. *See* JCT, JCX-54-10, *Estimated Budget Effects of the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," Scheduled for Consideration by the United States Senate* (Dec. 10, 2010), http://www.jct.gov/publications.html?func=startdown&id=3715.

27 TPC, T12-0171, *Characteristics of AMT Taxpayers with and without AMT Fix*, 2011-2013, 2022 (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3514.

28 TPC, T12-0171, *Characteristics of AMT Taxpayers with and without AMT Fix, 2011-2013*, 2022 (Sept. 13, 2012).

FIGURE 1.2.2, Percentage of Taxpayers Projected to Pay AMT in 2012 by Income with and without an AMT Patch[29]



Temporary or retroactive AMT patches appear less expensive than a permanent fix, but they add instability to the tax law, which causes problems for taxpayers and the IRS.[30] These retroactive changes can make it difficult for the IRS to timely publish accurate forms and program its systems to process early tax filings — sometimes delaying urgently needed refunds.[31] The IRS recently announced that it assumes Congress will pass an AMT patch before the end of 2012, so that Congress' failure to pass a patch would cause delays.[32] Congress' failure to do so could affect 80 to 100 million taxpayers - more than half of all filers - potentially delaying their refunds.[33]

29 *Id*. Dependents are excluded from the analysis. Taxpayers are defined as returns with positive income tax liability net of refundable credits. We use the term "paying" AMT to include paying AMT liability on Form 6251, as well as any reduction of credits or deductions. The TPC's estimates are based on a broad measure of income called "cash income," defined as adjusted gross income minus taxable state and local tax refunds, plus total deductions from AGI, non-taxable pension income, tax-exempt interest, non-taxable social security benefits, cash transfers, worker's compensation, employee's contribution to tax deferred retirement savings plans, employer's share of payroll taxes and corporate tax liability. *Id*. These projections assume that if an AMT patch is enacted for 2012 (*i.e.*, current policy), all the temporary provisions in place for calendar year 2011 are also extended, with the exception of the payroll tax cut. The projections for the AMT patch adopt the AMT patch specified in Senate bill S.3413, which sets the AMT exemption amount for 2012 at $50,600 for individuals and $78,750 for married taxpayers filing jointly.

30 As noted above, JCT recently estimated the cost of a permanent fix would be $855 billion over 10 years, but a two-year patch (for 2010 and 2011) would be $136.7 billion. CBO, *An Analysis of the President's 2013 Budget* 7 (Mar. 2012) (citing a JCT estimate for a permanent fix); JCT, JCX-54-10, *Estimated Budget Effects of the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," Scheduled for Consideration by the United States Senate* (Dec. 10, 2010) (AMT patch).

31 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 3-12 (Most Serious Problem: *The Impact of Late-Year Tax-Law Changes on Taxpayers*).

32 Letter from Acting IRS Commissioner to Ranking Member, House Committee on Ways and Means (Nov. 13, 2012); Letter from Acting IRS Commissioner to Chairman, House Committee on Ways and Means (Dec. 19, 2012).

33 *Id*. This figure exceeds the number subject to the AMT because (1) the patch generally includes tax credit ordering rules, which affect many taxpayers who are not subject to AMT, (2) the IRS would not be able to process certain forms and schedules from anyone, and (3) the IRS would not be able to process returns from anyone whose income level might subject them to the AMT. *Id.*

The AMT causes estimated tax underpayments, reducing tax compliance and increasing taxpayer burden.

Frequent AMT patches combine with the inherent complexity of the AMT to make it nearly impossible for taxpayers to estimate their tax liabilities in advance. The AMT is so complicated that the IRS's wage withholding calculator does not even consider the AMT in determining how much taxpayers should withhold.[34] Many taxpayers first learn they are subject to the AMT only after preparing their returns, when it is too late to increase their withholding or estimated tax payments. Taxpayers who did not withhold or pay enough estimated tax are subject to penalties. While we cannot determine how many taxpayers were subject to estimated tax penalties solely because of the AMT, IRS data shows that for tax year 2011, about 17 percent of those subject to the AMT were liable for estimated tax penalties, as compared to 4 percent of individual taxpayers overall.[35] Some taxpayers will not be able to afford to pay their tax (or penalties) in one lump sum at the end of the year. Thus, the unpredictability of the AMT likely reduces voluntary compliance.[36]

The AMT hinders informed debate about tax reform options.

The constantly-shifting AMT rules make it more difficult for the government to estimate its revenues and the actual cost of changes to the regular tax system. For example, extending the 2001-2010 individual income tax cuts may appear less costly because the AMT is projected to recoup nearly one quarter of those cuts.[37] At the same time, the cost of repealing the AMT may be exaggerated if estimators assume temporary tax cuts will be extended and that the AMT will generate revenue by negating those cuts. Notably, ten-year estimates of AMT revenue double (from $1.05 trillion to $2.19 trillion) if expiring tax cuts are extended.[38] As a result, the AMT makes it more difficult for the public to understand the true costs of fundamental tax reform.

Temporary AMT patches compound these difficulties. The bipartisan 2005 Tax Reform Panel observed, "a tax reform proposal that does not repeal the AMT effectively results in

34 The calculator refers taxpayers to Publication 919. *See* IRS Withholding Calculator (Jan. 25, 2012), http://www.irs.gov/individuals/article/0,,id=96196,00.html ("CAUTION: If you will be subject to alternative minimum tax, self-employment tax, or other taxes; you will probably achieve more accurate withholding by following the instructions in Publication 919, How Do I Adjust My Tax Withholding?"). Publication 919 instructs taxpayers to project their AMT liability by filling out Form 6251 or the Alternative Minimum Tax Worksheet in the Form 1040A instructions, a daunting task that few are likely to undertake before the end of the year, especially if they believe the law might change on a retroactive basis.

35 IRS Compliance Data Warehouse Individual Returns Transaction File and Individual Master File (Tax Year 2011). The National Taxpayer Advocate has recommended legislation to waive the estimated tax penalty for those who pay at least 100 percent of the amount due for the prior year, are subject to a *de minimis* penalty, or are first-time estimated taxpayers and have reasonable cause for the violation. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2 30-35.

36 Studies suggest that unexpected tax liabilities reduce filing, payment, and reporting compliance. *See* National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, at 30-35 (summarizing various studies).

37 TPC, T12-0176, *Effect of the AMT on 2001-2010 Individual Income Tax Cuts*, 2012 (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3519. According to JCT, it would cost $2.4 trillion over 10 years to make the 2001-2003 tax cuts permanent for low and middle income taxpayers if the AMT exemption is increased to 2011 levels and indexed for inflation. *See* JCT, JCX-27-12, *Estimated Budget Effects of the Revenue Provisions Contained In the President's Fiscal Year 2013 Budget Proposal* 3 (Mar. 14, 2012), http://www.jct.gov/publications.html?func=startdown&id=4412.

38 TPC, T12-0169, *Baseline AMT Projections, Aggregate AMT Projections, 2011-2022* (Sept. 13, 2012), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3512 (2013-2022).

a hidden, but real, future tax hike."[39] They may have been referring to the AMT patches, which are always scheduled to expire, essentially triggering a future tax hike. As noted above, the largest components of that tax hike involve eliminating the standard deduction and the deduction for state and local taxes, and imposing marriage penalties.[40] If Congress wanted to raise taxes in this manner, it could do so under the regular tax system. The merits of such a tax hike could easily be compared to alternative proposals for reform.

As the system is now structured, however, proponents of serious tax reform have to compare the cost of their proposals to current law, which includes a hidden tax increase because the AMT patch is always scheduled to expire. Alternative proposals that repeal the AMT may seem unduly expensive by comparison, even if the public would not accept and Congress would not adopt the hidden AMT tax increase that exists under the current law system of patches. As a result, it may be more difficult for the public to evaluate the true merit of realistic tax reform alternatives.

CONCLUSION

The National Taxpayer Advocate first recommended repeal of the AMT in the Annual Report to Congress for 2001 and has advocated for its repeal consistently over the past decade.[41] We reiterate this recommendation.

In 1999, Congress voted to repeal the individual AMT, but the legislation was vetoed.[42] The American Bar Association Section of Taxation, the American Institute of Certified Public Accountants Tax Division, and the Tax Executives Institute have jointly called for the repeal of the AMT.[43] The National Association of Enrolled Agents also advocated outright repeal or substantial restructuring of the AMT for individuals.[44] Similarly, both the 2005 Tax Reform Panel and the 2010 National Commission on Fiscal Responsibility and Reform (the Simpson-Bowles Commission) recommended repealing the AMT.[45] Leaders of both parties

39 The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* 43 (Nov. 2005), http://govinfo.library.unt.edu/taxreformpanel/final-report/index.html.

40 TPC, *AMT Preference Items 2002, 2004-2008* (Dec. 21, 2010), http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=468&Topic2id=30&Topic3id=36.

41 *See, e.g.*, sources cited *supra* note 2.

42 Taxpayer Refund and Relief Act of 1999, H.R. 2488, 106th Cong. (1999).

43 American Bar Association Section of Taxation, American Institute of Certified Public Accountants Tax Division & Tax Executives Institute, *Tax Simplification Recommendations, reprinted at 2000 TNT 39-82* (Feb. 28, 2000).

44 *2003 Tax Return Filing Season and the IRS Budget for Fiscal Year 2004: Hearing before the House Ways and Means Subcommittee on Oversight*, 108th Cong. (2003) (statement of Claudia Hill on behalf of the National Association of Enrolled Agents).

45 The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* xvii (Nov. 2005), http://govinfo.library.unt.edu/taxreformpanel/final-report/index.html; The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform*, 2010 TNT 231-35 sec. 2, fig. 7 (Dec. 3, 2010).

in both the House and Senate have also recently proposed repealing it.[46] For all of the reasons stated above, the National Taxpayer Advocate continues to recommend permanent repeal of the individual AMT.

46 *See, e.g.*, Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. (2007) (sponsored by Rep. Charles Rangel, Chairman, House Committee on Ways and Means, though the bill limits the benefits of repeal to lower income taxpayers); Individual AMT Repeal Act of 2007, H.R. 1366, 110th Cong. (2007); Taxpayer Choice Act of 2007, H.R. 3818, 110th Cong. (2007); Individual AMT Repeal Act of 2009, H.R. 240, 111th Cong. (2009); End Tax Uncertainty Act of 2011, HR. 86, 112th Cong. (2011); Individual AMT Repeal Act of 2011, H.R. 547, 112th Cong. (2011); Jobs Through Growth Act, H.R. 3400, 112th Cong. (2011); American Opportunity and Freedom Act of 2012, H.R. 3804, 111th Cong. (2012); Individual Alternative Minimum Tax Repeal Act of 2007, S. 55, 110th Cong. (2007) (sponsored by Max Baucus and Chuck Grassley, Senate Finance Committee, Chairman and Ranking Minority member, respectively, among others); Invest in America Act, S.14, 110th Cong. (2007); Individual Alternative Minimum Tax Repeal Act of 2007, S. 2293, 110th Cong. (2007); AMT Repeal and Tax Freedom Act, S. 2318, 110th Cong. (2007); Bipartisan Tax Fairness and Simplification Act of 2011, S. 727, 112th Cong. (2011).

MSP #3 The IRS is Significantly Underfunded to Serve Taxpayers and Collect Tax

DEFINITION OF PROBLEM

The IRS is significantly and chronically underfunded to serve America's taxpayers and collect the amount of tax due under law. Because of funding shortages:

- The IRS is unable to answer millions of taxpayer telephone calls;
- The IRS is unable to timely process taxpayer correspondence;
- The "tax gap" — the amount of tax due but uncollected — stands at nearly $400 billion each year;
- Taxpayers believe the tax laws are not being fairly enforced against others; and
- The federal budget deficit is unnecessarily large.

In each of the last two fiscal years, the IRS budget has been reduced, and it appears the IRS budget will be cut further in the current year. The continued underfunding of the IRS poses one of the greatest long-term risks to tax administration today.

In this section of the report and in accordance with our statutory mandate, we identify at least 20 of the most serious problems facing taxpayers. Some of the problems we identify result from poor planning or execution, and it is important that the IRS not use lack of funding as a justification for failing to address these problems. Areas where the IRS must improve its strategic approach include assisting victims of tax-related identity theft,[1] accepting voluntary disclosures from persons who belatedly report offshore accounts without subjecting them to draconian penalties in a wider array of cases,[2] assisting victims of return preparer fraud,[3] and allowing parents who adopt children to claim the adoption credit without incurring a vastly increased risk of an audit.[4]

However, the lack of sufficient funding is the sole or significant cause of many of the problems identified in this report. There are practical limits to how well the IRS can respond to tens of millions of telephone calls, more than 10 million letters, and hundreds of thousands of identity theft cases each year, as well as maintain robust tax-compliance programs including outreach and education, if it lacks adequate and educated personnel, technology, and other support.

1 See Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft, infra*.

2 See Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts, infra*.

3 See Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully, infra*.

4 See Most Serious Problem: *The IRS's Compliance Strategy for the Expanded Adoption Credit Has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS and Does Not Bode Well for Future Credit Administration, infra.*

The IRS is materially different from other discretionary programs in that it serves as the *de facto* Accounts Receivable Department of the federal government. Each dollar appropriated for the IRS generates substantially more than one dollar in additional revenue. It is therefore ironic and counterproductive that concerns about the deficit are leading to cuts in the IRS budget, when those cuts are making the deficit larger.

ANALYSIS OF PROBLEM

For purposes of the appropriations process, the IRS is treated as a domestic discretionary program, generally subject to the same funding rules as all other such programs. As Congress has curtailed discretionary spending to try to bring the federal deficit under control, the IRS budget has been cut. The IRS's budget was reduced slightly from fiscal year (FY) 2010 to FY 2011,[5] it was cut by an additional 2.5 percent from FY 2011 to FY 2012,[6] and it may be facing additional cuts (or small increases that fail to cover its rising costs) for the foreseeable future. From the standpoint of protecting taxpayer rights and maximizing revenue collection, that would be a disaster.

A. Revenue Collection: Reduced Funding Means Reduced Revenue Collection and a Larger Budget Deficit.

From a revenue standpoint, the IRS in FY 2012 collected about $2.52 trillion[7] on a budget of about $11.8 billion.[8] That translates to an average return-on-investment (ROI) of about 214:1. The marginal ROI of additional spending will not be nearly so large, but virtually everyone who has studied the IRS budget has concluded that the ROI of additional funding is positive. Just over a year ago, former Commissioner Shulman estimated in a letter to Congress that proposed cuts to the IRS budget would result in reduced revenue collection of *seven times* as much as the cuts.[9]

If the Chief Executive Officer of a Fortune 500 company were told that each dollar allocated to his company's Accounts Receivable Department would generate seven dollars in return, it is difficult to see how the CEO would keep his job if he chose not to provide the department with the resources it needed to collect its receivables. Yet that is exactly what has been happening with respect to IRS funding for years, and there has been little effort to fix this obvious problem.

5 *See* Department of Defense and Full-Year Continuing Appropriations Act, 2011, Pub. L. No. 112-10, § 1119, 1125 Stat. 38, 107 (2011), *at* http://www.gpo.gov/fdsys/pkg/PLAW-112publ10/pdf/PLAW-112publ10.pdf.

6 *See* Department of the Treasury, *FY 2013 Budget in Brief*, *at* http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/11.%20IRS_508%20-%20passed.pdf (showing a decline in enacted appropriations levels from FY 2011 to FY 2012).

7 Government Accountability Office (GAO), GAO-13-120, *Financial Audit: IRS's Fiscal Years 2012 and 2011 Financial Statements* 65 (Nov. 2012), *at* http://www.gao.gov/assets/650/649881.pdf.

8 Department of the Treasury, *FY 2013 Budget in Brief*, *at* http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/11.%20IRS_508%20-%20passed.pdf.

9 Letter from Douglas H. Shulman, Commissioner of Internal Revenue, to the chairmen and ranking members of the House Committee on Ways and Means (and its Subcommittee on Oversight) and the Senate Committee on Finance (Oct. 17, 2011), *at* http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/media/pdf/112/Rep_Lewis_IRS_Letter.pdf.

This is not a new issue. In our 2006 Annual Report to Congress, we discussed this issue in detail and recommended, among other things, that Congress consider revising its budget rules in a manner that allows the relevant congressional committees to consider and decide: "What level of funding will maximize tax compliance, particularly voluntary compliance, with our nation's tax laws, with due regard for protecting taxpayer rights and minimizing taxpayer burden?" and then set the IRS funding level accordingly, without regard to spending caps.[10]

In the course of developing and presenting that recommendation, the National Taxpayer Advocate or her senior advisor met with 14 separate congressional staffs — specifically, the House and Senate majority and minority staffs of the tax-writing committees, appropriations committees, and budget committees as well as tax counsel for the House and Senate majority leaders. In our discussions, there appeared to be no significant disagreement with the premise that the IRS generates a positive return-on-investment and is underfunded. However, we were repeatedly told that creating a new set of rules to establish IRS funding levels would be a "heavy lift." The last three IRS Commissioners have also raised this issue.[11] So have the former chairman and ranking member of the Senate Budget Committee.[12] In our view, the time to attempt the "heavy lift" is now.

B. Taxpayer Services: Reduced Funding Means Taxpayer Needs Are Not Being Met.

We recognize that few people enjoy paying taxes, and for that reason, recommending that Members support more funding for the IRS is not necessarily an easy sell. But there are multiple reasons why adequate IRS funding is important and why we think taxpayers would see it that way as well. The National Taxpayer Advocate is particularly concerned that the IRS is not receiving sufficient funds to meet the basic needs of taxpayers seeking to comply with the law. As we discuss elsewhere in this report, the IRS has received more than 115 million calls in each of the last two fiscal years.[13] That is a staggering volume of calls, and the IRS cannot come close to handling them all. Last year, the IRS answered only about 68 percent of calls from taxpayers seeking to speak with a telephone assistor,

10 See National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*), *at* http://www.irs.gov/pub/irs-utl/2006_arc_section2_v2.pdf.

11 *See, e.g.*, Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 278 (2005) ("When I talked to business friends about my job at the IRS, they were always surprised when I said that the most intractable part of the job, by far, was dealing with the IRS budget. The reaction was usually 'Why should that be a problem? If you need a little money to bring in a lot of money, why wouldn't you be able to get it?'").

12 In 2006, Senator Judd Gregg acknowledged that the existing budget procedures have the effect of shortchanging the IRS. He said: "We've got to talk to the [Congressional Budget Office] about scoring on [additional funding provided to IRS]. Clearly there's a return on that money." Dustin Stamper, *Everson Pledges to Narrow Growing Tax Gap*, 110 Tax Notes 807 (Feb. 20, 2006). Similarly, Senator Kent Conrad stated: "Rather than a tax increase, I think the first place we ought to look . . . is the tax gap. If we could collect this money, we'd virtually eliminate the deficit." Emily Dagostino, *Senate Budget Resolution Would Increase IRS Enforcement Funding*, 110 Tax Notes 1129 (Mar. 13, 2006).

13 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (weeks ending Sept. 30, 2011 and Sept. 30, 2012); see Most Serious Problem, *The IRS Telephone and Correspondence Services Have Deteriorated Over the Last Decade and Must Improve to Meet Taxpayer Needs*, *infra*.

and those who got through had to wait on hold for an average of nearly 17 minutes.[14] That represents a sharp drop-off in performance as compared with the IRS's high-water mark in FY 2004, when it answered 87 percent of its calls and the average hold time was just over 2½ minutes.[15]

The IRS's ability to timely process taxpayer correspondence has also diminished in recent years. Last year, the IRS received more than ten million letters from taxpayers responding to IRS adjustment notices.[16] Comparing the final week of FY 2012 with the final week of FY 2004, the backlog of taxpayer correspondence in the tax adjustments inventory increased by 188 percent (from 357,151 to 1,028,539 pieces), and the percentage of correspondence classified as "overage" jumped by 316 percent (from 11.5 percent to 47.8 percent).[17]

Congress has enacted laws that now require more than 140 million individuals to file income tax returns. The National Taxpayer Advocate believes that when taxpayers are attempting to comply with laws that require them to turn over a significant portion of their incomes to pay our nation's bills, they have a right to expect that their government will take their telephone calls and answer their letters. When the IRS fails to answer one out of three phone calls, makes callers wait an average of nearly 17 minutes on hold, and cannot timely process nearly half of its pending correspondence, it falls well short of providing the service that taxpayers deserve.[18]

The IRS in recent years has also been struggling to cope with a rising volume of tax-related identity theft cases.[19] As of September 30, 2012, the IRS had almost 650,000 identity theft cases in inventory servicewide.[20] The victims of tax-related identity theft suffer extraordinary inconveniences and, in many cases, hardships. In general, more than 75 percent of U.S. taxpayers receive refunds, with the amount averaging about $3,000.[21] Identity theft victims generally cannot receive their significant and sometimes urgently needed tax refunds until the IRS resolves their cases, which is now taking six months or longer.[22]

14 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2012). The Accounts Management phones lines (previously known as the Customer Account Services (CAS) phone lines) receive the significant majority of taxpayer calls. However, taxpayer calls to compliance phone lines and certain other categories of calls are excluded from this total.

15 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2004).

16 *See, e.g.*, IRS, Joint Operations Center, *CAS Accounts Management Paper Inventory Reports: FY12 July-September Fiscal Year Comparison*.

17 *Compare* IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 29, 2012) *with* IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2004).

18 Insufficient funding affects the IRS's performance in many other areas as well. For example, the IRS has been ramping up its use of automated processes as a replacement for personnel in handling a greater share of its auditing and collection activities. While most taxpayers do not relish the prospect of being contacted by an examination or collection employee, we have documented previously that taxpayers are substantially better off communicating with a person than a programmed computer. *See* National Taxpayer Advocate Blog, *Are IRS Correspondence Audits Really Less Burdensome for Taxpayers?* (Feb. 6, 2012), *at* http://www.taxpayeradvocate.irs.gov/Blog/are-irs-correspondence-audits-really-less-burdensome-for-taxpayers; National Taxpayer Advocate 2011 Annual Report to Congress 336-349 (Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*). Insufficient funds also mean that IRS employees do not receive adequate training to assist taxpayers as well as they should.

19 *See* Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft, infra*.

20 *See* IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Oct. 24, 2012).

21 *See* IRS Filing Season Statistics – Dec. 31, 2011, *at* http://www.irs.gov/uac/Filing-Season-Statistics----Dec.-31,-2011.

22 *See* Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft, infra.*

The IRS needs sufficient funding to address an important equity concern as well. Compliant taxpayers pay a great deal of money each year to subsidize noncompliance by others. According to the IRS's most recent estimate, the net tax gap stood at $385 billion in 2006,[23] when there were 116 million households in the United States.[24] This means that each household was effectively paying a "surtax" of some $3,300 to subsidize noncompliance by others. That is not a burden we should expect our nation's taxpayers to bear.

Yet because of funding constraints, the IRS's ability to ensure that all taxpayers pay their fair share of taxes is limited. The IRS now audits just about one percent of individual taxpayers, and because traditional face-to-face audits are relatively expensive, it performs many audits by automated correspondence. About three out of four audits of individual taxpayers are now limited-issue examinations conducted by mail.[25] Thus, the IRS in FY 2011 conducted traditional face-to-face audits of just one out of every 360 taxpayers.[26]

C. The "Program Integrity Cap Adjustment" Mechanism Has Significant Drawbacks.

For the reasons described above, the National Taxpayer Advocate recommends that Congress increase funding for the IRS.

In making this recommendation, however, we emphasize that the IRS must maintain a balanced compliance program that places priority emphasis on promoting voluntary front-end compliance and does not place excessive weight on back-end enforcement. Several Appropriations acts in recent years have given the IRS additional funding using a mechanism known as a "program integrity cap adjustment." Under this mechanism, new funding appropriated for IRS enforcement programs generally does not count against otherwise applicable spending ceilings provided:

1. The IRS's existing enforcement base is fully funded; and
2. A determination is made that the proposed additional expenditures will generate a return on investment of greater than 1:1 (*i.e.,* the additional expenditures will increase federal revenue on a net basis).

Funding for taxpayer service activities has been excluded from this enhanced funding mechanism. The rationale is that the IRS is able to measure the direct ROI of its enforcement activities — *i.e.,* it can compute to the dollar the amounts collected by its Examination, Collection, and document-matching functions — but at present it is unable

23 *See* IRS News Release, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study*, IR-2012-4 (Jan. 6, 2012), *at* http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study. The "net" tax gap reflects the amount by which tax liabilities exceed tax collection after accounting for late payments and enforced collections. The "gross" tax gap – the amount unpaid timely and before enforced collections – was estimated to be $450 billion.

24 U.S. Census Bureau, Table H-1, *Income Limits for Each Fifth and Top 5 Percent of All Householders: 1967 to 2011*, *at* http://www.census.gov/hhes/www/income/data/historical/household/index.html.

25 IRS, Fiscal Year 2011 Enforcement and Service Results, *at* http://www.irs.gov/pub/newsroom/fy_2011_enforcement_results_table.pdf.

26 *Id*.

to quantify the ROI of taxpayer services. Thus, it is not currently possible to document whether or the extent to which its taxpayer services generate an ROI greater than 1:1.

Although we recognize that the program integrity cap adjustment mechanism is a well-intentioned attempt to provide the IRS with increased funding, we think such an "enforcement-only" cap adjustment is an impeccably poor workaround for two reasons. First, common sense tells us that taxpayer services are a significant driver of tax compliance and generate a very high ROI. Publishing tax forms and instructions, conducting outreach and education to taxpayers, tax preparers, and tax software manufacturers, and otherwise administering the tax filing season are absolute prerequisites for tax compliance. In general, the ROI of these service activities is almost surely greater than the ROI of enforcement actions, and as we document in this report, the IRS could do a lot to improve its taxpayer services if it received additional funding for that purpose.

Second, an enforcement-only cap adjustment will inherently push the IRS to become more of a hard-core enforcement agency. It should be emphasized that in FY 2011, direct enforcement revenue came to only $55.2 billion,[27] or 2 percent, of total IRS tax collections of $2.42 trillion.[28] The remaining 98 percent of IRS tax collections resulted from voluntary front-end tax compliance. If cap adjustments are applied solely to bolster enforcement funding, the relative allocation of the IRS budget between enforcement and taxpayer service will shift over time in a direction that causes taxpayers to fear the IRS more and voluntarily cooperate less. In our effort to enforce the laws against noncompliant taxpayers, we must take care to avoid steps that may alienate compliant taxpayers and thereby jeopardize the existing tax base.

If the treatment of the IRS budget is not fundamentally revamped along the lines we are recommending and program integrity cap adjustments continue to be used as an alternative, we recommend that compliance measures be defined more broadly, so that they include both an enforcement component and a service component. Because the projected ROI of many enforcement programs is high, a more broadly constructed initiative could still produce a demonstrable ROI of greater than 1:1, even if it contained service components with a positive but unquantifiable ROI. For example, IRS data show that compliance rates among small businesses are relatively low. A portion of the noncompliance is attributable to the fact that financially unsophisticated individuals starting businesses as, for example, landscapers or plumbers do not understand and therefore find it difficult to comply with the income tax accounting rules and the complex payroll tax withholding, reporting, and payment requirements.

Common sense suggests that an initiative aimed at improving small business tax compliance should contain an outreach and education component to help these taxpayers

27 IRS, Fiscal Year 2011 Enforcement and Service Results, *at* http://www.irs.gov/pub/newsroom/fy_2011_enforcement_results_table.pdf.

28 Government Accountability Office, GAO-13-120, *Financial Audit: IRS's Fiscal Years 2012 and 2011 Financial Statements* 65 (Nov. 2012), *at* http://www.gao.gov/assets/650/649881.pdf.

understand the rules. Yet the costs of conducting outreach and education have not been treated as eligible for program integrity cap adjustments because the ROI of those activities cannot be precisely quantified. That should change. If the IRS were to combine the costs of outreach and education with the costs of traditional enforcement measures as part of a comprehensive "small business compliance initiative," it could show that the initiative as a whole would generate a positive ROI based simply on the revenue the enforcement measures would generate — and the true ROI would be substantially higher, even if unquantifiably so. That approach would produce better results, and it would not require the IRS to emphasize enforcement over taxpayer service activities just to obtain funding.[29]

CONCLUSION

Because the IRS is the federal government's accounts receivable department and generates a substantially positive return on investment, it is self-defeating to treat the agency like a pure spending program. With most spending programs, a dollar spent is simply a dollar spent from a budget perspective. With the IRS, a dollar spent generates many dollars in additional revenue, and conversely, a dollar not spent translates to a greater decrease in revenue collection, thereby adding to the budget deficit. Recent cuts in the IRS budget have also limited the IRS's ability to meet the basic service needs of the taxpaying public, which erodes public confidence in the tax system and may also lead to greater noncompliance. For these reasons, we believe the time has come for Congress to "fence off" decisions about IRS funding from the otherwise applicable spending ceilings that apply to discretionary appropriations under the budget rules.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress consider the following actions:

1. Revise the budget rules so that the IRS is "fenced off" from otherwise applicable spending ceilings and is viewed more like an accounts receivable department. It should be funded at a level designed to maximize tax compliance, particularly voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.
2. In allocating IRS resources, keep in mind that tax compliance requires a combination of high quality taxpayer service, outreach and education, and effective tax-law enforcement, and the IRS should continue to maintain a balanced approach toward that end. We are concerned that the program integrity cap adjustment procedures used in the past skew this important balance and should be avoided, but if cap adjustments

[29] In past reports, we have written about local compliance initiatives the IRS has undertaken that include integrated enforcement and outreach and education components. *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 176-192 (Most Serious Problem: *Local Compliance Initiatives Have Great Potential but Face Significant Challenges*). One example: In the early 1990s, the IRS launched an initiative designed to address noncompliance by fishermen in Alaska that resulted from confusion as well as community norms and attitudes. The IRS combined stepped-up enforcement activities with an extensive outreach and education campaign in remote fishing villages and on fishing vessels that included assisting with tax return preparation and training local volunteers to assist taxpayers. By the end of the initiative, the number of nonfilers among the target population declined by 30 percent. *Id*. at 177-178.

continue to be used, we recommend they be written in a manner that applies to broadly defined compliance initiatives that include both taxpayer service (including outreach and education) and enforcement components.

MSP #4 The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Becky Chiaramida, Director, Office of Privacy, Governmental Liaison, and Disclosure

DEFINITION OF PROBLEM

In general, tax-related identity theft occurs when an individual intentionally uses the personal identifying information of another person to file a false tax return with the intention of obtaining an unauthorized refund.[1] Identity theft wreaks havoc on our tax system in many ways. Victims not only must deal with the aftermath of an emotionally draining crime, but may also have to deal with the IRS for years to untangle the resulting tax account problems. Identity theft also impacts the public fisc, as Treasury funds are diverted to pay out improper refunds. In addition, identity theft takes a significant toll on the IRS, tying up limited resources that the IRS could shift to taxpayer service or compliance initiatives.

In April 2008, former Commissioner Shulman appeared before Congress and stated, "My overall goal as the IRS Commissioner is that when a taxpayer contacts us with an issue or concern, we have in place a seamless process that gets the issue resolved promptly."[2] In October 2008, the IRS established the Identity Protection Specialized Unit (IPSU), a unit dedicated to assisting victims of identity theft. However, the Commissioner's vision has yet to be realized. The help the IRS has offered to the victims of this crime has been anything but seamless and prompt.

The National Taxpayer Advocate has written and testified extensively about the impact of identity theft on taxpayers and tax administration, and has made many specific, concrete recommendations to improve IRS efforts to assist taxpayers who become identity theft victims.[3] While the IRS has adopted several of TAS's recommendations, it has not responded with the urgency that the identity theft crisis demands. Despite the proclamation of the Commissioner to Congress that identity theft is a top priority, victims who come to the IRS for assistance today will routinely need to speak with multiple employees and wait more

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

2 *See Identity Theft in Tax Administration*, Hearing Before the Senate Committee on Finance, 110th Cong. (Apr. 10, 2008) (statement of Doug Shulman, IRS Commissioner).

3 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); *Identity Theft and Income Tax Preparation Fraud*, Hearing Before the H. Comm. on the Judiciary, Subcomm. on Crime, Terrorism, and Homeland Security, 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (June 28, 2012).

than six months to have their issues resolved. In fact, the IRS has now established 21 different units to address identity theft cases,[4] many with their own rules and procedures — a far cry from the initial vision of the centralized "traffic cop" function the National Taxpayer Advocate recommended and the Commissioner committed to in 2008.

Meanwhile, tax-related identify theft continues to grow at an alarming pace. In fiscal year (FY) 2012, the IPSU received nearly 450,000 cases, a 78 percent increase over FY 2011.[5] TAS has experienced a similar increase in stolen identity case receipts; an increase of over 60 percent from FY 2011 to FY 2012, and an increase of more than *650 percent* from FY 2008.[6] Identity theft cases comprise 25 percent of TAS's FY 2012 case receipts and were the number one issue in TAS case receipts for the last two fiscal years.[7]

Identity theft cases are complex, often encompassing multiple issues and tax years.[8] TAS case advocates are unique in that they both serve as a single point-of-contact for taxpayers and work to resolve all of the taxpayer's related issues completely before closing cases. Despite TAS's extensive experience working complex identity theft cases, TAS was not afforded an opportunity to review the IRS's procedures before some of the specialized identity theft units became operational. The National Taxpayer Advocate believes the IRS's failure to draw upon the collective expertise of TAS and its employees is a significant oversight that will result in less effective case-resolution procedures.

As of September 30, 2012, the IRS had almost 650,000 identity theft cases in inventory servicewide.[9] Much of the IRS's focus in the past few years has been on revenue protection (that is, developing filters designed to prevent the payout of questionable refund claims). The National Taxpayer Advocate urges the IRS to expend as much effort as necessary to reduce the time it takes to fully resolve an identity theft victim's case.

The National Taxpayer Advocate is concerned that:

- The IRS is moving backward — away from a centralized approach to assisting identity theft victims — and is increasing the risk that taxpayer-victims may fall through the cracks;
- After years of ineffective efforts to reengineer its processes, the IRS still takes too long to fully resolve the accounts of victims;

4 *See* IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Oct. 24, 2012).

5 IRS, *IPSU Identity Theft Report* (Sept. 29, 2012). This inventory includes all identity theft cases controlled by the IPSU paper unit, including self-reported non-tax-related identity theft cases, cases the IPSU monitors, and cases undergoing global account review. It does not include cases that meet TAS's "systemic burden" case criteria, which the IPSU tracks separately. Total IRS FY 2012 ID Theft receipts were 449,809 compared to 253,051 in FY 2011, an increase of 77.8 percent.

6 TAS analysis of Taxpayer Advocate Management Information System (TAMIS) data. TAS received 54,748 ID theft cases in FY 2012, compared with 34,006 in FY 2011, and 7,147 in FY 2008 for an increase of 666.0 percent

7 *Id.* TAS received 54,748 ID theft cases in FY 2012, or 24.9 percent of its 219,666 total cases.

8 *Id.* TAS received 54,748 ID theft cases in FY 2012, of which 37,307 (68.1 percent) included more than one issue code per case.

9 *See* IRS Identity Theft Advisory Council, Identity *Theft Status Update* (Oct. 24, 2012). Actual number is 646,950.

- While the Identity Protection Personal Identification Number (IP PIN) that the IRS has developed provides additional security, it does not cover all victims;
- The Taxpayer Protection Unit may not be sufficiently staffed to handle the volume of calls from impacted taxpayers;
- Congress may unnecessarily create additional exceptions to taxpayer privacy protections; and
- The Social Security Administration still makes the Death Master File available to the public, creating an opportunity for identity thieves to steal and then misuse personal information.

ANALYSIS OF PROBLEM

Background

In general, identity theft occurs in tax administration in two ways — when an individual intentionally uses the SSN of another person to:

1. File a false tax return with the intention of obtaining an unauthorized refund; or
2. Gain employment under false pretenses.

In both situations, the victim is often sent on a journey through IRS processes and procedures that may take years to complete.

The National Taxpayer Advocate has consistently urged the IRS to improve its strategy for assisting identity theft victims. Since 2004, the National Taxpayer Advocate included identity theft as a Most Serious Problem six times in her Annual Report to Congress.[10] In just the past year, the National Taxpayer Advocate has testified about this topic before Congress in five separate hearings.[11]

10 National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307-317 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79-94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2005 Annual Report to Congress 180-191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2004 Annual Report to Congress 133-136.

11 *See Identity-Theft Related Tax Fraud*, Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Organization, Efficiency and Financial Management, 112th Cong. (Nov. 29, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *Identity Theft and Income Tax Preparation Fraud*, Hearing Before the H. Comm. on the Judiciary, Subcomm. on Crime, Terrorism, and Homeland Security, 112th Cong. (June 28, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *Identity Theft and Tax Fraud*, Hearing Before the H. Comm. on Ways and Means, Subcomm. on Oversight and Social Security, 112th Cong. (May 8, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *Tax Compliance and Tax-Fraud Prevention*, Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Organization, Efficiency, and Financial Management, 112th Cong. (Apr. 19, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *Tax Fraud by Identity Theft Part 2: Status, Progress, and Potential Solutions*, Hearing Before the S. Comm. on Finance, Subcomm. on Fiscal Responsibility and Economic Growth, 112th Cong. (Mar. 20, 2012) (statement of Nina E. Olson, National Taxpayer Advocate).

In addition, former Commissioner Shulman (or his designee) has discussed the problem in at least five hearings before Congress.[12] The IRS has established numerous task forces and Lean Six Sigma teams focused on improving identity theft processes. Despite all of this attention, victims who need their tax accounts corrected quickly and effectively still face many of the same issues they did five years ago — a labyrinth of procedures and drawn-out timeframes for resolution.[13]

With the IRS Moving Away from a Centralized Approach to Identity Theft Victim Assistance, Taxpayers Will Fall Through the Cracks.

In former Commissioner Shulman's first month in office, he testified before the Senate Finance Committee on identity theft. At this hearing and through his responses to follow-up questions, the Commissioner described his vision for addressing the issue. In describing the IPSU, the Commissioner stated:

> This unit will provide end-to-end case resolution. Victims will be able to communicate with one customer service representative to have their questions answered and issues resolved quickly and efficiently.... We have found that over time, identity theft cases can be handled by approximately 24 functional areas of the IRS, including customer service, tax return processing, and compliance, and we believe this unit will assist taxpayers whenever the need arises in dealing with identity theft.[14]

The National Taxpayer Advocate generally agrees with the approach outlined by the Commissioner in 2008 — a single point of contact, seamless assistance, and prompt resolution. However, it is clear that the promises made by the Commissioner are not being fulfilled. Not only has the IRS failed to achieve the goals expressed by the Commissioner in 2008, but it is moving backward. As discussed below, the IRS is heading toward a *decentralized* approach to aiding identity theft victims, who are unlikely to describe the assistance they receive as "quick" or "efficient." In short, it is replacing the 24 units the Commissioner identified as a problem in 2008 with 21 units today — hardly the single point of contact envisioned.

In 2011, the IRS convened yet another task force to look at its victim assistance strategy. In the view of many participants, the external consulting firm leading this task force came

12 *See Identity Theft and Tax Fraud*, Hearing Before the H. Comm. on Ways and Means, Subcomm. on Oversight and Social Security, 112th Cong. (May 8, 2012) (statement of Steven T. Miller, IRS Deputy Commissioner for Services and Enforcement); *Tax Compliance and Tax-Fraud Prevention*, Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Organization, Efficiency, and Financial Management, 112th Cong. (Apr. 19, 2012) (statement of Steven T. Miller, IRS Deputy Commissioner for Services and Enforcement); *Identity Theft and Tax Fraud: Growing Problems for the Internal Revenue Service*, Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Organization, Efficiency, and Financial Management, 112th Cong. (Nov. 4, 2011) (statement of Steven T. Miller, IRS Deputy Commissioner for Services and Enforcement); *IRS E-File and Identity Theft*, Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Organization, Efficiency, and Financial Management, 112th Cong. (June 2, 2011) (statement of Doug Shulman, IRS Commissioner); *Identity Theft in Tax Administration*, Hearing Before the Senate Committee on Finance, 110th Cong. (Apr. 10, 2008) (statement of Doug Shulman, IRS Commissioner).

13 Unfortunately, the IRS did not track cycle time on identity theft cases until this year, so we have no empirical data on ID theft case cycle time to analyze.

14 *See Identity Theft in Tax Administration,* Hearing Before the Senate Committee on Finance, 110th Cong. (Apr. 10, 2008) (statement of Doug Shulman, IRS Commissioner).

in with the pre-conceived notion that the IRS should move away from centralized victim assistance and toward a specialized approach. Based upon a recommendation from this task force, IRS leadership decided to create a specialized unit *within each of its 21 individual departments* (or functions) to work on identity theft cases.[15] Under this approach, identity theft cases would be assigned to specially trained employees in each function. If an identity theft case involves multiple issues, the case may be transferred to a specialized unit in a different function to address the additional issue(s).[16] The IRS maintains that transfers of cases between functions will be the exception rather than the rule, but based upon TAS's experience with identity theft cases over the years, it is foreseeable that transfers between functions will become commonplace.

In 2012, each function was asked to develop procedures for its embedded identity theft unit. The IRS-wide Office of Privacy, Governmental Liaisons, and Disclosure (PGLD) was tasked with compiling and reviewing such procedures to ensure some level of consistency. Although TAS has asked to review these procedures before these embedded units became operational in October 2012, we were not afforded this opportunity in all cases. At least three of these embedded specialized units began work without having their procedures reviewed by TAS.[17]

In addition, PGLD is coordinating the development of employee guidance that spells out how and when a taxpayer's case will be moved from one embedded unit to another. Although the National Taxpayer Advocate and Taxpayer Advocate Service staff have asked to review such procedures to ensure that they do not increase taxpayer burden or impair taxpayer rights, as of October 26, 2012, PGLD has not shared a final transfer matrix with TAS for review.

The National Taxpayer Advocate firmly believes that the IRS needs a centralized body (such as the IPSU) to serve as the "traffic cop." Identity theft cases are often complex, requiring adjustments by multiple IRS departments.[18] Without a case coordinator, the risk that cases requiring involvement from multiple functions will get "stuck" or fall through the cracks is high. The IPSU has already been serving in this capacity for four years. Under the new, specialized approach to identity theft victim assistance, it is unclear what the role of the IPSU will be. In our view, the IPSU should remain the single point of contact for victims, tracking each case from start to finish as it moves from one specialized unit to another. Each function should have a liaison and service level agreement or memorandum

15 IRS, *Identity Theft Assessment and Action Group (ITAAG) Future State Vision and Supporting Recommendations* 44 (Oct. 11, 2011).

16 If a function contemplates a scenario in which it would not work all aspects of the case, it would submit a request for exception to the office of Privacy, Governmental Liaison, and Disclosure (PGLD). PGLD is currently developing a transfer matrix to facilitate such transfer requests.

17 The Compliance Post-Adjustment Team and Designated Identity Theft Adjustment units stood up in April 2012, but TAS did not receive procedures until October 2012. Submission Processing's embedded unit became operational in October 2012, without sharing its procedures with PGLD or TAS prior to stand up.

18 An IRS task force found that up to 28 different functions may touch an identity theft case. IRS, *Identity Theft Assessment and Action Group (ITAAG) Future State Vision and Supporting Recommendations* 7 (Oct. 11, 2011).

of understanding with the IPSU and be held accountable for meeting established deadlines for taking actions.[19]

In addition, the IPSU should continue to serve an important role in this process by conducting a global account review on all identity theft cases. To provide the best service, the IPSU should conduct two global account reviews — an initial one to identify all related issues prior to transferring the case to the appropriate specialized units, and a final global review to ensure that all issues have been resolved prior to closing any identity theft case. Despite its "specialized" moniker, the IPSU should actually operate as a hub in a centralized environment to ensure a "seamless" experience for the victim.[20]

Identity Theft Cases Now Comprise 25 Percent of TAS Case Receipts and Clearly Show That Many Identity Theft Cases Involve More Than One Issue.

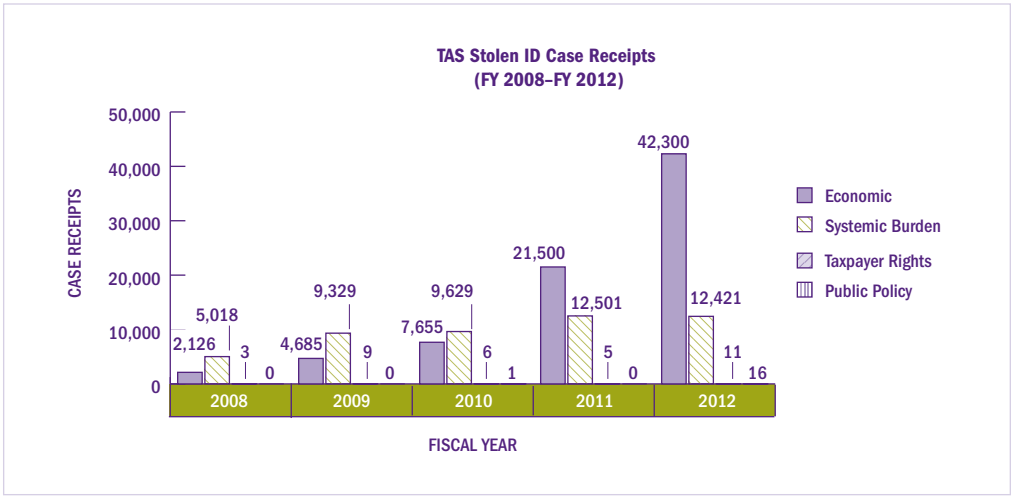
When established IRS procedures do not work as intended, taxpayers turn to the Taxpayer Advocate Service for assistance. The volume of identity theft cases in TAS has risen each year since the IRS established the IPSU, from about 7,100 in FY 2008 to nearly 55,000 in FY 2012, an increase of more than 650 percent.[21]

19 A service level agreement (SLA) outlines the procedures and responsibilities for the processing of casework when the authority to complete certain case actions rests outside of one organization, operating division, or function. The SLA defines roles and responsibilities, and includes procedures for elevating disagreements. TAS established SLAs with each OD/function for the processing of TAS Operations Assistance Requests (OARs). The SLAs identify timeframes for acknowledging and assigning OARs, procedures for handling disagreements over actions requested or timeframes for completing actions.

20 From the outset, the National Taxpayer Advocate has inquired about the role of the IPSU in the new specialized environment. After months of what appeared to be stonewalling, the IRS finally created a team to look at the IPSU and invited TAS to participate. However, the "IPSU re-engineering" team that TAS was invited to join appeared to have no real decision-making authority with respect to the IPSU's interaction with the embedded specialized units.

21 Data obtained from TAMIS on October 16, 2012. TAS received 7,147 identity theft cases in FY 2008, compared to 54,748 in FY 2012, a 666.0 percent increase.

FIGURE 1.4.1, TAS Stolen Identity Case Receipts, FY 2008 to FY 2012[22]



In FY 2012, identity theft cases constituted 25 percent of TAS's case receipts, more than any other issue in TAS case inventory. Moreover, identity theft has been the top issue in TAS case receipts for the last two fiscal years. When TAS case advocates receive a case, they assign Primary and (one or more) Secondary Issue Codes to the case, indicating what issues are involved in the case and, by inference, what functions TAS must work with to resolve all the tax issues completely before closing the case. In fact, identity theft cases are complex, often encompassing multiple issues and tax years. The table below shows the various secondary issues associated with TAS identity theft cases closed in FY 2012.

22 *Id.* TAS received 54,748 identity theft cases in FY 2012, out of 219,666 total cases (24.9 percent).

TABLE 1.4.2, FY 2012 TAS Identity Theft Closures by Secondary Issue[23]

Top Ten Secondary Issues	Closed Cases	Avg. Case Age (Days)
Unspecified [24]	13,306	95
020 - Expedite Refund Requests	9,216	98
310 - Processing Original Returns	5,582	109
045 - Pre-Refund Wage Verify Hold	5,529	86
315 - Unpostable/Reject	3,190	74
330 - Processing Amended Returns	1,046	112
090 - Other Refund Inquiries	974	115
040 - Returned/Stopped Refunds	848	92
410 - Multiple/Mixed TIN	813	132
060 - IRS Offset	669	139
670 - Closed Automated Underreporter	603	133
All Other Secondary Issues	4,846	132
Total	**46,622**	**101**

For example, if there is a problem with an unpostable return, TAS would need to interact with the Submission Processing function. If there are issues related to wage or withholding verification, TAS would coordinate with the Accounts Management Taxpayer Assurance Program (AMTAP) function. With levy or offset issues, TAS may need to deal with the Collection function. Any given case could involve several tax years with any combination of these issues. It is highly unlikely that 21 separate units will be able to resolve complex cases involving multiple units without a "traffic cop" that owns the case, serves as the taxpayer's single point-of-contact, and is ultimately held responsible for its timely and correct resolution.

The IRS Still Takes Much Too Long to Fully Resolve the Accounts of Identity Theft Victims.

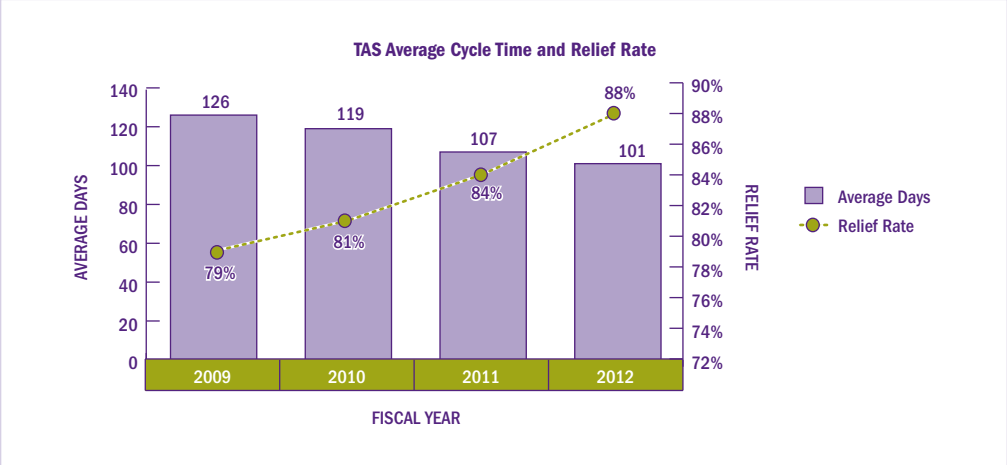
As discussed above, the National Taxpayer Advocate and TAS understand all too well that identity theft cases can be very complex, and, it takes time to work through all related issues. When TAS accepts a case, TAS case advocates must work with the appropriate IRS function to get them to make the necessary decisions and take the appropriate steps to resolve issues. Case advocates set specific timeframes within which those actions must be completed by the IRS functions. Thus, TAS case cycle time represents the "best case" for identity theft victims – there is someone watching over the IRS and making sure that it takes actions timely and correctly, and that cases don't languish or disappear between functions.

23 Data obtained from TAMIS on October 16, 2012.

24 Pursuant to TAS guidance, identity theft cases, by definition, have at least one secondary issue. However, a portion of TAS identity theft cases did not specify a secondary issue code, which is an error.

The chart below shows the average number of days it took TAS to close a stolen identity case from FY 2009 to FY 2012, along with the relief rate obtained in those cases. As the chart shows, since FY 2009, TAS's identity theft case cycle time decreased by 20 percent, even as its relief rate rose from 79 percent to 88 percent.[25] In other words, in 88 percent of the cases, taxpayers who came to TAS were the victims of identity theft and entitled to relief.

FIGURE 1.4.3, TAS Stolen Identity Case Cycle Time and Relief Rate, FY 2009 to FY 2012[26]



In 2008, former Commissioner Shulman made a commitment that the IRS would resolve identity theft victims' tax accounts "promptly." The IRS cannot determine how well it has done in meeting this commitment, because until this year, the IRS had no ability to track identity theft case inventory, much less monitor how long it takes to resolve cases. Even today, while some IRS functions track the length of time a case is in its inventory, the IRS cannot provide an overall average cycle time for its identity theft cases. For one prominent category of identity theft work, the IRS reports an average closure time of 196 days.[27]

We are by no means attempting to minimize the complexity of identity theft cases, but taking well over six months to close an identity theft case is simply not acceptable for the hundreds of thousands of victims. Remarkably, rather than acknowledging the need to

25 Analysis of TAMIS data conducted on October 17, 2012. One reason for the decrease in cycle time is a favorable change in IRS procedures. When we first started writing about identity theft, the IRS had no procedures that would allow its employees to determine the rightful owner of an SSN in question. Instead, the IRS would send the case to the Social Security Administration (SSA) for resolution, which would routinely take two years. *See* IRM 21.6.2.4.4.2 (Oct. 1, 2012). In the 2005 Annual Report, the National Taxpayer Advocate recommended that the IRS train and empower its employees to make such determinations without involving the SSA. *See* National Taxpayer Advocate 2005 Annual Report to Congress 183. Today, the IRS not only allows its employees to determine SSN ownership based on documentation, but uses data mining to speed up the process even more. We view this as a significant advance and applaud the IRS for this change.

26 Analysis of TAMIS data conducted on October 16, 2012.

27 *See* IRS response to information request (Nov. 5, 2012). IDTX (monitoring tax-related identity theft cases) cases were open an average of 196 days.

work identity theft cases faster and streamlining its procedures, the initial IRS response has been to lower taxpayers' expectations. In September 2012, the IRS instructed employees to advise identity theft victims that *it would take 180 days to resolve their cases.*[28] (These instructions were rescinded shortly thereafter when the National Taxpayer Advocate objected to its release.)

One consequence of the IRS taking so long to resolve an identity theft case is that many victims will enter the following filing season with unresolved account issues. Because the IRS will generally issue identity protection personal identification numbers (discussed later) only to taxpayers with fully resolved identity theft issues, many victims will still be at risk of having a perpetrator steal their refund again the following year, and will require further assistance later on. To avoid such consequences, the IRS must ensure that identity theft cases do not languish and must strive to resolve them completely in well under six months.

The National Taxpayer Advocate believes the IPSU, in its role as the "traffic cop," needs more effective tools to achieve this goal. Although IPSU requests are supposed to receive priority treatment from other IRS organizations, some IPSU cases are not considered "aged" until after 180 days have passed.[29] The IPSU has no way to ensure that the other functions adhere to the requested timeframes. The IPSU should enter into agreements with each of the specialized units working identity theft cases to specify timeframes for action, along with consequences for not meeting the timeframes.

While the Identity Protection Personal Identification Number Program Provides Additional Security, It Covers Only Part of the Identity Theft Victim Population.

For the 2012 filing season, the IRS introduced a number of identity theft-related process improvements. For example, to provide a greater level of security for taxpayers, the IRS issued identity protection personal identification numbers (IP PINs) to about 250,000 victims whose identities and addresses it has verified.[30] An IP PIN is a unique code that the taxpayer must use, along with his or her taxpayer identification number, to file electronically and bypass certain filters. Letters went out in December 2011, instructing the victims to use the IP PINs to file their 2011 returns. If the taxpayer attempts to e-file without that number, the IRS will not accept it and the taxpayer will need to file a paper return, which will delay processing.

For the 2013 filing season, the IRS plans to expand the IP PIN program to more than 600,000 participants. We support expansion to as many verified identity theft victims as possible, provided the IRS can validate their current addresses. In general, the IRS does not issue IP PINs until after the victim's account is resolved. Contrary to IRS practice, the

28 SERP Alert 12A0535, *Identity Theft Timeframe - 180 Days* (Sept. 4, 2012).

29 IRM 21.9.2.1(6) (Oct. 1, 2011).

30 The IRS issued 251,568 IP PINs. IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Aug. 23, 2012).

protection of the taxpayer should begin as soon as the SSN owner and address is verified. Tying the IP PINs to *closing* of the identity theft case unnecessarily delays this protection.

From the inception of the program, TAS has advocated for immediate delivery of the IP PIN to victims whose identities and addresses the IRS has verified. The IRS advised that it could not do this systemically for the 2012 filing season, but would be open to it for the following year. Yet the IRS still does not allow identity theft victims to be assigned IP PINs throughout the year, increasing the risk of delay and economic hardship to taxpayers who have already been victimized at least once.

We note that many of the nearly 650,000 victims with cases in inventory will not be afforded the protection of the IP PIN because their cases will not be fully resolved by the time IP PINs are mailed out, which means their accounts will be unprotected from fraudulent filings.[31] This is another reason why it is imperative that the IRS work through identity theft cases as soon as it can. To this end, the IRS has diverted personnel from Taxpayer Assistance Centers and other departments to assist with the backlog of identity theft cases, and continue working on them during the 2013 filing season.[32]

In October 2012, the National Taxpayer Advocate expressed concern to W&I management that the nearly 22,000 taxpayers with stolen identity cases in TAS inventory would not receive the benefit of the protections afforded by the IP PIN for the 2013 filing season.[33] The Accounts Management (AM) unit shared this concern and worked feverishly to develop a work-around solution. For identity theft cases that have been through the Electronic Fraud Detection System, the IRS would place an "S" indicator on the account to signify the true SSN owner and an "N" indicator on the account to signify the non-SSN owner. (At the National Taxpayer Advocate's suggestion, the IRS refrained from using the typical "good"/"bad" designation.) We are pleased to report that these taxpayers will be eligible to receive the IP PIN for use in the 2013 filing season and appreciate AM working with us. However, until the IRS changes its procedures to place the IP PIN marker on accounts upon verification rather than closure, the IRS will continue to waste resources on one-off adjustments and work-arounds.

It is inevitable that a certain percentage of taxpayers will misplace or forget to use the IP PIN. Despite the IRS's attempts to verify the taxpayers' addresses, over 9,000 letters

31 The inventory of identity theft cases at the end of FY 2012 was 646,950. IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Oct. 24, 2012).

32 To assist with the backlog of identity theft cases in Accounts Management, the IRS temporarily moved 170 employees from Taxpayer Assistance Centers (TACs). Diverting these TAC employees to work identity theft issues reduces their availability to assist taxpayers in other matters. *See* Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra.*

33 As of October 16, 2012, there were 21,908 open stolen identity cases in TAS.

containing the IP PINs were returned undeliverable in 2012.[34] In addition, the IRS received almost 23,000 (about nine percent) requests for replacement IP PINs in 2012.[35]

Without replacement numbers, these taxpayers will need to file paper returns and be subject to additional scrutiny and delay. The IRS says that for the 2013 filing season, it will be easier and quicker to obtain a replacement, as taxpayers can request a new PIN by phone from any IRS customer service representative after validating their identity.

The Taxpayer Protection Unit Requires Sufficient Staffing to Handle the Volume of Calls from Impacted Taxpayers.

In the current environment, the IRS is under tremendous pressure to protect Treasury revenue from improper refund claims. During the 2012 filing season, the IRS designed and implemented several identity theft filters to weed out suspicious returns. Through data mining, programmers attempted to detect trends based on a variety of factors and develop customized filters to isolate suspicious claims for refunds.

The IRS notified affected taxpayers by letter that it had a problem processing their returns and instructed them to call the new Taxpayer Protection Unit (TPU) to provide more information.[36] Initially, this unit was woefully understaffed to handle the volume of calls from taxpayers trying to figure out why their returns were not being processed. For the week ending March 10, 2012, the level of service (LOS) on this unit's phone line was a dismal 11.7 percent. This means the IRS failed to answer eight of every nine calls — and taxpayers who got through had to wait on hold an average of an hour and six minutes![37]

The chart below shows the level of service and average wait time for the TPU toll-free line for March and April 2012, at the height of the filing season.

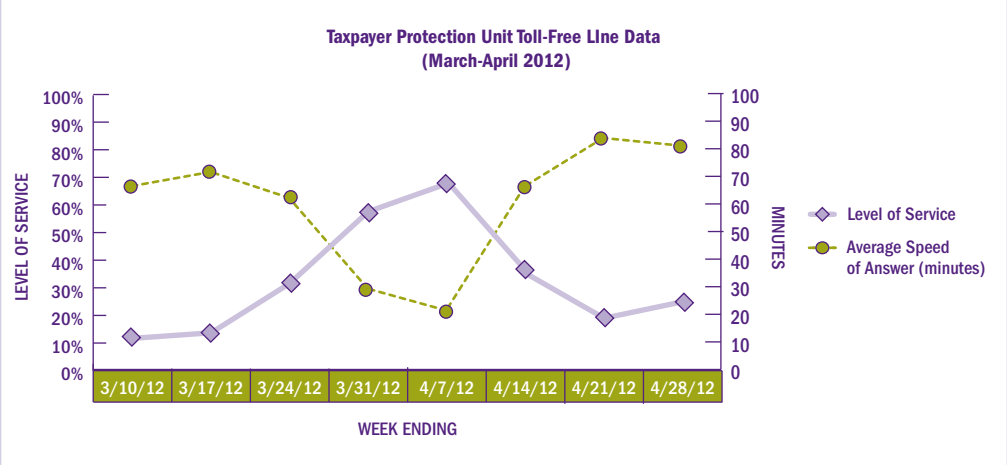
34 9,137 letters containing IP PINs were undeliverable through September 30, 2012. IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Aug. 23, 2012).

35 The IRS received 22,814 requests for replacement IP PINs during 2012 (January through September 30, 2012). IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Aug. 23, 2012). The actual number of taxpayers who requested a replacement IP PIN was 20,848. *See* IRS, *IP PIN Replacement Program* (Apr. 5, 2012).

36 The Taxpayer Protection Unit should not be confused with the IPSU, which assists victims of identity theft. The number to the TPU phone line was provided to taxpayers who received a letter due to the identity theft filters implemented in the 2012 filing season. Victims of identity theft are still instructed to call the toll-free line operated by IPSU.

37 The average speed of answer was 3,991 seconds. IRS, Joint Operations Center Executive Level Summary Report (Mar. 10, 2012).

FIGURE 1.4.4, Taxpayer Protection Unit Toll-Free Line Data (Mar. and Apr. 2012)[38]



In the following weeks, the IRS provided additional staffing for the TPU in an attempt to boost the level of service. During FY 2012, the TPU had achieved an overall LOS of 45.5 percent, about half the 85 percent goal.[39]

It seems not only that the IRS misjudged the number of customer service representatives needed to staff this line, but also that the identity theft filters have picked up more returns than anticipated. *With such a low level of service, it is impossible to assign legitimacy to any IRS estimate of the filters' accuracy.* If fewer than half of the attempts at calling the number listed in the notice get through to the TPU, how can the IRS accurately assess the success of the identity theft filters?

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

In the 2011 Annual Report to Congress, the National Taxpayer Advocate recommended that Congress enact a comprehensive Taxpayer Bill of Rights, and suggested that the right to confidentiality is one of those core taxpayer rights.[40] Taxpayers have the right to expect that any information they provide to the IRS will not be used or disclosed by the IRS unless authorized by the taxpayer or other provision of law.

The Internal Revenue Code (IRC) contains significant protections for the confidentiality of returns and return information. IRC § 6103 generally provides that returns and return information shall be confidential and then delineates a number of exceptions to this general rule. Section 6103(i)(2) authorizes the disclosure of return information in response to requests from federal law enforcement agencies for use in criminal investigations. There

38 IRS, Joint Operations Center, Executive Level Summary Reports (Mar. 10 - Apr. 28, 2012).

39 *See* IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Oct. 24, 2012).

40 National Taxpayer Advocate 2011 Annual Report to Congress 505.

is no corresponding exception in IRC § 6103 that allows for the release of identity theft information to *state or local* agencies.[41] However, IRC § 6103(c) provides that a taxpayer may consent to disclosure of returns and return information to any person designated by the taxpayer.

Some have called for the expansion of exceptions to IRC § 6103, ostensibly to help state and local law enforcement combat identity theft. The National Taxpayer Advocate has significant concerns about loosening taxpayer privacy protections and does not believe that such an expansion of the statute is appropriate at this time. The current framework of IRC § 6103 includes sufficient exceptions to allow the IRS to share information about identity thieves.

The IRS Office of Chief Counsel has advised that the IRS may share the "bad return" and other return information of an identity thief with other federal law enforcement agencies investigating the identity theft.[42] In light of this advice, the IRS has implemented a pilot program in the state of Florida to facilitate a consent-based sharing of identity theft information with state and local law enforcement agencies.[43] Through August 23, 2012, the IRS received 664 requests from identity theft victims to share information.[44] The IRS stated that it is aware of press articles covering a couple of indictment/arrest type scenarios related to information provided under the pilot program. It should be noted there is no requirement for state and local agencies to provide data regarding the outcome of cases related to the waiver pilot.

We believe this approach strikes an appropriate balance — protecting taxpayer return information while simultaneously giving state and local law enforcement authorities more information to help them investigate and combat identity theft. However, we are concerned that once the information is in the hands of state and local law enforcement, there is no prohibition in the tax code against redisclosure. Therefore, the National Taxpayer Advocate suggests that Congress consider modifying IRC § 6103(c) to explicitly limit the use of tax return information to the purpose agreed upon by the taxpayer (*i.e.*, to allow state or local law enforcement to use the information solely to enforce state or local laws) and to prohibit the redisclosure of such information.[45]

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

42 IRS Office of Chief Counsel Memorandum, *Disclosure Issues Related to Identity Theft*, PMTA 2012-05 (Jan. 18, 2012).

43 The IRS has expanded the pilot program to work with law enforcement in eight additional states: Alabama, California, Georgia, New Jersey, New York, Oklahoma, Pennsylvania, and Texas. *See* http://www.irs.gov/uac/Law-Enforcement-Assistance-Pilot-Program-on-Identity-Theft-Activity-Involving-the-IRS (last visited Nov. 9, 2012).

44 E-mail from Senior Advisor, Criminal Investigation Division, Refund Crimes (Aug. 27, 2012).

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

In the meantime, the IRS should insert into every agreement with state and local agencies an explicit clause that says this information may only be used for prosecution of identity theft-related crimes. Any other disclosure or use should void the agreement.

The Federal Government Facilitates Tax-Related Identity Theft by Publicly Releasing Significant Personal Information of Deceased Individuals.

The federal government unwittingly facilitates tax-related identity theft by making public the Death Master File (DMF), a list of recently deceased individuals that includes their full name, SSN, date of birth, date of death, and the county, state, and ZIP code of the last address on record.[46] The SSA characterizes release of this information as "legally mandated" under the Freedom of Information Act,[47] but this position has not been tested.[48] To eliminate uncertainty, the National Taxpayer Advocate recommended in 2011 that Congress pass legislation to clarify that public access to the DMF can and should be limited.[49]

The National Taxpayer Advocate has raised this issue at every opportunity over the past two years.[50] Although some genealogy websites have voluntarily agreed to curtail the availability of DMF information, not much has been done by either Congress or the executive branch. In the meantime, taxpayers continue to face harm due to the inaction of the government.[51] Thus, while waiting for legislative action, the National Taxpayer Advocate urges the SSA to reconsider its legal analysis and take steps to restrict access to the DMF.

The IRS Should Include TAS Representatives in All Levels of Identity Theft Program and Procedural Planning

TAS employees work each case they receive until all related issues are resolved. TAS employees also interact with every IRS function during the course of working cases. Their global perspective, along with the experience gained from working the significant volume of identity theft cases that TAS receives, qualifies some TAS employees as experts in identity theft processing. To ensure the IRS receives the benefit of TAS's broad experience in assisting identity theft victims, the IRS should consider TAS as equal partners and include TAS representatives in all levels of identity theft program and procedural planning, including front-line teams, training development, guidance, and advisory and executive steering committees.

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

47 FOIA generally provides that any person has a right to obtain access to certain federal agency records. *See* 5 U.S.C. § 552.

48 *Social Security and Death Information*, Hearing Before H. Comm. on Ways & Means, Subcomm. on Soc. Security, 112th Cong. (statement of Michael J. Astrue, Commissioner of Social Security) (Feb. 2, 2012).

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

50 *See* National Taxpayer Advocate FY 2012 Objectives Report to Congress xxvii (June 2011); National Taxpayer Advocate 2011 Annual Report to Congress 9, 519; *Identity Theft and Tax Fraud*, Hearing Before the Subcomm. on Oversight and Social Security, H. Comm. on Ways and Means, 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (May 8, 2012); National Taxpayer Advocate FY 2013 Objective Report to Congress 12 (June 2012).

51 For a detailed analysis of the government's obligation to release personal information of decedents, see *Identity Theft and Tax Fraud*, Hearing Before the Subcomm. on Oversight and Social Security, H. Comm. on Ways and Means, 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (May 8, 2012).

CONCLUSION

When former Commissioner Shulman took office in 2008, he expressed to Congress a specific plan of action to address identity theft victim assistance. Almost five years later, it is evident that the IRS has not accomplished its goals of providing seamless account resolution in a timely fashion.

In conclusion, the National Taxpayer Advocate preliminarily recommends that the IRS:

1. Issue IP PINs throughout the year, as soon as the identities and addresses of the rightful SSN owner are verified. The issuance of IP PINs should not be tied to the final resolution of an identity theft case.
2. Retain the Identity Protection Specialized Unit as the single point of contact with identity theft victims throughout the duration of their cases.
3. Move the Identity Protection Specialized Unit out of the Accounts Management function, to afford it greater autonomy as it acts as the face of the IRS to identity theft victims.
4. Expand the Identity Protection Specialized Unit's role in managing identity theft case resolution, such as conducting initial and final global account reviews on all identity theft cases.
5. Provide sufficient staffing for the Identity Protection Specialized Unit to take on this expanded role.
6. Implement agreements between the Identity Protection Specialized Unit and the various functions that work identity theft cases to set forth acceptable timeframes for completing the required actions and consequences for not meeting the timeframes.
7. Strive for a Level of Service within the Taxpayer Protection Unit equal to or greater than the Level of Service goal set for the main toll-free phone line.
8. Insert into every agreement with state and local agencies an explicit clause that says that return information of an identity thief may be used only for prosecution of identity theft-related crimes (with no redisclosure to third parties).
9. Together with the Social Security Administration, seek modification of the consent judgment requiring the release of personal identifying information of decedents.
10. Include TAS at all levels of identity theft program and procedural planning, including front-line teams, training development, guidance, and advisory and executive steering committees.

IRS COMMENTS

Combating identity theft and providing victim assistance are top priorities of the IRS. The IRS is committed to helping the victims of identity theft and, while more work remains, we have made significant progress this year. As the report recognizes, identity theft cases are complex, often encompassing multiple issues and tax years. Although we cannot stop all identity theft, our efforts in filing season 2012 provide a solid foundation upon which we will continue to build and improve. During the first ten months of this calendar year, the IRS protected more than $20 billion of revenue related to fraudulent returns, including identity theft. We strengthened our preventative measures to catch identity theft before erroneous refunds are issued and increased our investigative efforts to detect and prosecute perpetrators of refund fraud.

We continually review our policies and procedures to ensure we are doing everything possible to minimize the incidence of identity theft, help victims, and investigate perpetrators. Once a legitimate taxpayer's account is identified, marked, adjusted, and closed, it is the IRS's intent to ensure that future filings of returns by these taxpayers are protected from further harm or burden. Business rules are implemented to identify unique characteristics of fraudulent returns submitted by identity thieves, and used as a basis for rejecting them if these characteristics surface. We have also implemented new procedures to resolve cases more efficiently and accurately, as well as found additional ways to reduce customer burden. These efforts include, but are not limited to the following:

- Implementing programming to identify returns with ID theft documentation;
- Revising procedures to utilize Information Returns Processing Transcript data to identify the SSN owner and reduce processing time;
- Implementing a tool to review multiple accounts quickly and identify accounts that have high potential for ID theft;
- Initiating programming changes to systemically identify and send cases with ID theft markers directly to ID theft specialized groups for processing; and
- Expanding the IP PIN program from 53,000 IP PINs in 2010, to more than 250,000 in TY 2011 and more than 600,000 TY 2012.

We strongly disagree that the IRS "has not responded with the urgency that the identity theft crisis demands." The IRS's comprehensive identity theft strategy squarely focuses on both fraud prevention and victim assistance. We acknowledge that fighting identity theft will continue to be an ongoing battle for the IRS, but we take great pride in the advancement of our efforts and the noteworthy successes we have attained over the past year.

Contrary to the assertion in the report, the IRS's streamlined approach closely aligns itself with the vision of having the point of contact be a person knowledgeable of the specific identity theft issue and authorized to execute the actions necessary to resolve the problem. Accordingly, we believe it is a mischaracterization to state that the IRS is heading toward a

decentralized approach in light of how the specialized groups function. The specialization process allows the IRS to utilize the unique skill sets and experience of dedicated employees, who work in strict accordance of service-wide policy, procedures, and processing timeframes that instill consistency and efficiency. Specialization not only provides a single point of contact for the taxpayer, but it also affords the taxpayer with the expertise needed to handle all aspects of their case. It should be noted that the Identity Theft Assessment and Action Group was a servicewide team represented by all organizations impacted by identity theft, including TAS. We continue to believe that the decision to implement specialized groups was a sound one and is beginning to pay significant dividends.

As stated in the report, IRS functions were asked to develop procedures for their embedded identity theft units; however, the IRS established consistent and mandatory requirements for developing these procedures. For example, these requirements set specific guidelines regarding prioritization, documentation, communications, and adjustments. An essential aspect of these requirements and capabilities is making the taxpayer whole while minimizing instances where accounts are transferred between functions. The IRS's Office of Privacy, Governmental Liaison and Disclosure has overseen the development of a "transfer matrix" which accounts for all identity theft processing scenarios to minimize case transfers and provide taxpayers a seamless customer service experience. As new scenarios are identified, PGLD will work with the other IRS functions and incorporate as necessary. The IRS is currently finalizing the "transfer matrix" and will share this guidance with all identity theft stakeholders, including TAS.

Additionally, in July 2012, PGLD revised its IRM 10.5.3, to serve as the "hub" IRM for the IRS's servicewide identity theft guidance and establish a reference point for all identity theft work. PGLD worked closely with the specialized groups to develop any remaining procedures necessary to account for the intricacies of their respective functions. It should be noted that all identity theft guidance is reviewed by PGLD using the IRS's Internal Management Document (IMD) process in which TAS is also included. Job aids from these functions were posted to the IRS's Servicewide Electronic Research Program (SERP), where they are readily available for review and comment. The functions worked with TAS to provide updates to the TAS Service Level Agreement Addendums for TAS Operations Assistance Request (OAR) routing, and PGLD has met regularly with TAS staff to provide updates on the specialized teams.

In light of the specialized approach and additional reengineering efforts and advancements made by the IRS, the IRS recently convened a multi-functional team, including TAS, to explore the future state of the Identity Protection Specialized Unit. In an effort to ensure efficient processing of IDT cases and the avoidance of duplicate work, the IRS is investigating IPSU activities such as third-party monitoring to determine if IPSU work overlaps with that of the specialized teams. The reengineering team will analyze and evaluate IDT work processes and develop strategic changes to ensure a balance between service to customers and available resources.

The IRS acknowledges that many taxpayers continue to seek TAS assistance on identity theft issues, as evidenced by the increase in case receipts over the past four years. However, it should be noted that the largest number of TAS receipts reflect Economic Burden cases which by their very nature are routed directly to TAS without allowing the IRS an opportunity to take actions to resolve the taxpayer's issue. Additionally, it should be noted that the information in TAS's summary of Secondary Issues (table and subsequent example cited in the Most Serious Problem) supports the need for the IRS's specialized group process. In the example, the taxpayer's account has more than one issue, which, under the "traffic cop" proposal, would require additional coordination between the appropriate functions. Under the specialized process, both issues can be worked by the same function unless a complexity issue required another's involvement. Thus, we believe that the specialized process would prove beneficial to TAS and the taxpayers who come to it for assistance. We will, however, continue to monitor to ensure that the process works as intended.

We disagree that IRS cannot adequately track how many identity theft cases it has in inventory and how much time it takes to work an identity theft case. Since February 2012, all functions report their inventory to PGLD on a monthly basis while working towards the development of servicewide system, and this data is shared monthly with TAS during the Identity Theft Executive Steering Committee and Advisory Council meetings. Additionally, in June 2012, the IRS developed a comprehensive "global report" that tracks servicewide refund fraud and identity theft metrics. The IRS continues to make strides in developing processes to track the time it takes to resolve an identity theft case from receipt to closure. At the present time, only those functions with relatively small amounts of inventory are unable to do so, whereas Accounts Management (which historically works over 90 percent of all identity theft cases) has been providing these data since early 2012.

Similarly, we disagree that the IRS has lowered taxpayer expectations regarding the time it takes to work a case. The IRS has taken numerous steps to quickly identify and streamline its identity theft processes through a variety of reengineering initiatives. New procedures are in place to identify the legitimate taxpayer's return, correct taxpayer account data and initiate refunds to identity theft victims more quickly. One such procedure added the use of Electronic Fraud Detection System data as a tool to determine the true SSN owner, thus eliminating numerous research steps and improving efficiencies. Additionally, new programming to identify returns with identity theft documentation attached was implemented. Cases are now generated directly to the specialized groups, reducing the amount of cases that pass through several areas.

The IRS is dedicating a significant number of additional resources to identity theft. The IRS has nearly tripled the number of employees working identity theft cases. The IRS also initiated the Taxpayer Protection Unit in FY 2012 to provide a centralized staff to assist taxpayers in processing their returns. The overwhelming response to the TPU necessitated additional staffing and the IRS is increasing staffing in this area in FY 2013 to achieve an appropriate level of service. Moreover, the IRS improved its identity theft training efforts

in 2011 (and again in 2012) to ensure that all public contact employees had the tools they needed to respond appropriately to those who have been victimized by identity theft. We developed a new training course that includes sensitivity training as well as training on the proper tools and techniques for handling identity theft cases. In all, 35,000 IRS employees received this training in preparation for filing season 2012 and even more have taken (or are scheduled to complete this training) for filing season 2013.

The IRS appreciates the acknowledgement in the report of the work in the Identity Protection PIN program. The IP PIN is issued to select ID theft victims whose identities have been validated by the IRS, allows legitimate returns to be processed, and prevents processing of fraudulent returns, thereby mitigating processing delays in ID theft victims' federal tax return processing. Generally, the IP PIN is mailed out once the taxpayer's account has been resolved. Current programming allows one IP PIN to be generated each year. The IRS is exploring the feasibility of being able to provide IP PINs *on demand* though current programming limits IP PIN generation to once annually. This limitation is attributable to various factors that include the posting of identity theft markers, the IRS's year-end IT conversion process, and taxpayer correspondence issuance. The inclusion of cases within the IP PIN universe, only after an account was finally resolved, provided an added layer of taxpayer protection through the use of business rules if the taxpayer chose to file their return without an IP PIN. Additionally, for the 2013 filing season, the IRS expanded the IP PIN population by applying a temporary marker to accounts for which the legitimate taxpayer was determined and the correct address verified, even though the account had not been completely resolved. Temporary markers were input on approximately 100,000 accounts. This innovative and collaborative approach to working active ID theft inventory provides added protection and reduces burden on taxpayers in the event the perpetrator attempts to misuse the TP's identity before the account is resolved.

Taxpayers who misplace their IP PIN can contact the IRS by calling the IPSU, the 1-800 assistance line, or visit any taxpayer assistance walk in center. Taxpayers will be asked to validate their identities by answering a series of basic questions mandated by the IRM for disclosure level authentication.[52] Once the taxpayer's identification is validated through this process, they will be provided with a replacement IP PIN for use on their TY 2012 return. The replacement IP PIN will allow the taxpayer to e-file their return and, subject to standard validation checks, be accepted. The return will be subjected to a manual validation process prior to being allowed to post.

With respect to the IPSU, this unit will continue operations as it has since its inception in October 2008. The cross-functional IPSU Reengineering Team is studying the future role of IPSU. We are awaiting the team's final analysis and recommendations before making any changes to IPSU operations. The IRS will consider the recommendations of the National Taxpayer Advocate regarding the IPSU.

52 IRM 21.1.3.2.3 (Nov. 13, 2012); IRM 21.1.3.2.4 (Dec. 12, 2011).

The IRS agrees that the practice of public release of the Death Master File should be changed. The IRS continues to work with SSA and the Administration on a legislative solution that would limit public release of the DMF.

The IRS views TAS as a valued partner in the discussion and development of identity theft procedures and processes and looks forward to continued collaborations in the future. TAS is already included in all identity theft governance meetings (Advisory Council and Executive Steering Committee) and is a team member on numerous other identity theft-related initiatives such as the Accounts Management Reengineering and IPSU future state teams. The IRS will continue to seek the input and participation of TAS on future endeavors.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate appreciates the difficulty the IRS faces in serving as both the protector of the federal fisc and as the tax administrator responsible for delivering refunds to millions of taxpayers. With the volume of fraudulent refund claims, many of which involve identity theft, increasing significantly over the years, IRS resources are understandably stretched thin. To its credit, the IRS is exploring ways to more effectively detect and stop fraudulent claims. It is also moving to a specialized approach to victim assistance.

In its response, the IRS states that its "streamlined approach closely aligns itself with the vision of having the point of contact be a person knowledgeable of the specific identity theft issue and authorized to execute the actions necessary to resolve the problem." The National Taxpayer Advocate does not oppose the IRS's decision to create specialized identity theft units in each function, and recognizes there will be some efficiencies gained in having a small group of employees focus solely on identity theft cases. However, she also notes that these employees will often not have the capability to address all related issues presented in their cases.

As the National Taxpayer Advocate has consistently and frequently pointed out to senior IRS officials, the IRS does not know the full scope of issues presented in any given identity theft case because, unlike TAS, it does not track this information. The IRS works the vast majority of its identity theft cases as "single issue" cases. For example, if a case is in the Accounts Management (AM) function because the processing of taxpayer's current year's return is blocked by the IRS's acceptance of a return filed by an identity thief (known in IRS parlance as a "duplicate return"), AM employees only work that issue. They do not undertake a global account review to identify any prior returns that may be affected or whether there is impending audit or collection action with respect to impacted prior year returns.

Thus, the IRS does not know enough about the make-up or complexity of identity theft cases in its inventory to project how many cases will require the involvement of multiple units. The only comprehensive source of information about the composition of identity theft casework is TAS. Since our inception, we have tracked identity theft cases in our inventory, and until 2012, TAS was the only function in the IRS that could reliably report how many identity theft cases it was working at any one time and over time. While TAS's case inventory may not be identical to the IRS's, TAS is the *sole* reliable source of historic and current information about the scope of issues and complexity presented in identity theft cases. As noted earlier, identity theft is now the number one issue in TAS casework, constituting over a quarter of our case receipts. This has made us experts on identity theft work.

It is this experience that leads to the National Taxpayer Advocate's sense of urgency. In our view, the IRS still does not understand the full scope of the problem and is developing procedures that will continue to harm identity theft victims. The National Taxpayer Advocate does not want to be in the situation, several years from now, of saying "I told you so." She wants the IRS to address her concerns in a comprehensive way *now*.

As noted earlier, the vast majority of TAS identity theft cases involve multiple issues. The IRS states that "[u]nder the specialized process, both issues can be worked by the same function unless a complexity issue required another's involvement." The National Taxpayer Advocate disagrees strongly with the IRS's complacent assessment. Our analysis of TAS casework shows that the *vast majority* of identity theft cases involve multiple issues, often requiring actions by employees from different functions and with different skills. Unless the IRS is going to reproduce each of those functions within each of the 21 embedded units, cases will need to be transferred from one function to another regularly — and with much greater frequency than the IRS anticipates. And once the case is transferred, it is unclear whether the original employee working the case will continue to be the point of contact for the taxpayer or whether the taxpayer will be given a new contact employee in the new function. As anyone who has ever sought to resolve an issue with the IRS knows, the IRS is not exactly a model of ease and transparency in terms of the taxpayer's ability to communicate with specific employees. It is only TAS that assigns one case advocate to work a case from start to finish, addressing all issues. Without a traffic cop to ensure that the victim's case is properly and timely transferred between functions, the risk is too great that the case will get lost among the 21 different specialized units.

Since writing the initial discussion for this Most Serious Problem, the National Taxpayer Advocate has had in-depth discussions with both the Acting Commissioner and the Commissioner of the Wage and Investment Division, laying out her concerns about the operation of the specialized units. She has proposed what is an extremely reasonable alternative approach. Identity theft cases come to the IRS from multiple sources. Where the IRS receives calls on its toll-free assistance line, cases that appear to present only one issue can be routed to the appropriate specialized unit, as currently planned. The assigned

employee in that specialized unit would be required to conduct a global account review on that taxpayer's identification number. If the global account review shows that there are other issues or other years impacted by identity theft, the specialized unit would continue to work its narrow portion of the case, but oversight of the case would be transferred immediately to the IPSU, which would serve as the "traffic cop" for the case and ensure that all units do their part to ensure that the issues are timely and effectively resolved. Where the IPSU receives calls directly, the IPSU would conduct its own global account review and direct cases to the appropriate specialized unit(s). If the global account review shows that there is only a single issue in the case, the IPSU would transfer oversight of the case to the specialized unit.

The National Taxpayer Advocate's proposed approach combines the benefits of having dedicated experts in each specialized unit with the reality of the complexity and number of issues and years presented in the majority of identity theft cases. The IRS's approach, on the other hand, does not address taxpayers' needs and will further burden and harm the victims.

In addition, the IPSU must be strengthened and adequately staffed for either approach to work. Although the IPSU has existed since 2008, it does not appear to us that the IRS has used it optimally. In our view, the IPSU not only should serve as the traffic cop that routes the case to the appropriate function(s), but also should perform triage to prioritize which actions should be taken first to minimize harm. The IPSU re-engineering team made a number of recommendations that TAS concurs with, but it also suggested reducing the monitoring function of the IPSU — an idea we strongly oppose. As we have stated, we believe the IPSU should have increased ability to monitor ID theft cases.

The National Taxpayer Advocate acknowledges the recent improvements PGLD has made in tracking the inventory of identity theft cases and the case cycle time, but believes it should perform much more data analysis. As noted above, we did not claim that the IRS cannot currently track the number of identity theft cases or its cycle time; rather, we stated that *until this year*, the IRS could not "track identity theft case inventory, much less monitor how long it takes to resolve cases." We maintain that although many IRS functions now track the time an ID theft case is in its inventory, the IRS cannot provide an overall average cycle time. Furthermore, the IRS starts tracking the age of an identity theft case from the date it processes identity theft documentation, not the date the taxpayer provides the documentation. This means the cycle time reported by the IRS may be significantly shorter than the actual time a victim must wait for his or her account to be resolved.

In its comments, the IRS notes that it has taken steps to streamline its identity theft case resolution processes through a number of reengineering initiatives and by dedicating additional staffing resources. While we applaud these actions, we are disappointed that the IRS has not committed to a firm goal of reducing case cycle time. As we noted, the average

closure time for one prominent category of identity theft work was 196 days in FY 2012.[53] This does not include the time the IRS spent reviewing and processing the documentation (such as the identity theft affidavit) provided by the taxpayer to substantiate his or her identity, so in reality, the case cycle time is much longer than six months.

As this report goes to press, the IRS is yet again seeking to send letters to identity theft victims asking that they wait 180 days while the IRS works their cases. The National Taxpayer Advocate is concerned that this letter will send a message to IRS employees that it is acceptable to make identity theft victims wait six months. She notes that despite all the improvements to processing that the IRS says it has made over the years, the cycle time for identity theft victim assistance remains as long as it was years ago.

As of September 30, 2012, the IRS had almost 650,000 identity theft cases in inventory servicewide.[54] The victims of tax-related identity theft suffer extraordinary inconveniences and, in many cases, hardships. In general, more than 75 percent of U.S. taxpayers receive refunds, with the amount averaging about $3,000.[55] Identity theft victims generally cannot receive their significant and sometimes urgently needed tax refunds until the IRS resolves their cases, which is now taking six months or longer. The IRS's failure to provide timely relief to these identity theft victims is simply unacceptable.

If the IRS prioritizes identity-theft victim assistance to the extent its response suggests, it would set firm goals for its employees to provide prompt and comprehensive relief to victims. Reasonable goals include:

- Conducting a global account review upon receipt of a taxpayer's claim of identity theft in whichever IRS function serves as the taxpayer's first point of contact so that the case is appropriately routed;
- Determining who is the legitimate taxpayer within 45 to 60 days from date of the taxpayer's documentation submission; and
- Taking all closing actions with respect to processing the impacted return, including issuing any refunds in the quickest manner possible and marking the identity theft victim's account as eligible for an IP PIN, within 30 days from the date of making the identity determination.

These goals address the taxpayer's immediate anxiety and needs with respect to recognition of his or her identity and financial distress by requiring employees to meet accelerated timeframes for the return-processing component of the case, while affording the IRS the time it needs to resolve more complex and downstream issues. Importantly, they would halve the current cycle time experience to 90 days.

53 *See* IRS response to information request (Nov. 5, 2012). IDTX (monitoring tax-related identity theft cases) cases were open an average of 196 days.

54 *See* IRS Identity Theft Advisory Council, *Identity Theft Status Update* (Oct. 24, 2012).

55 *See* IRS Filing Season Statistics – Dec. 31, 2011, *available at* http://www.irs.gov/uac/Filing-Season-Statistics----Dec.-31,-2011 (last visited Dec. 28, 2012).

In conclusion, the National Taxpayer Advocate reiterates that TAS's experience in working thousands of identity theft cases each year from beginning to end affords us a unique perspective on how to improve the process. Since 2004, the National Taxpayer Advocate has made numerous recommendations in her Annual Reports to Congress to strengthen the ways the IRS helps victims. As the table below shows, the IRS ultimately adopted many of TAS's recommendations — often after initially opposing them. The National Taxpayer Advocate urges the IRS to use the knowledge gained from TAS's vast experience to improve its identity theft victim assistance procedures, and thoughtfully consider all of our recommendations.

TABLE 1.4.5, TAS RECOMMENDATIONS FOR HELPING ID THEFT VICTIMS ADOPTED BY THE IRS

MSP Year	Rec. #	TAS Recommendation	Year First Recommended	Year IRS Adopted
2004	9-A2	Revise the IRM to provide that scrambled procedures be used only after phone contact is attempted with the SSN users and only in those cases where available information clearly supports use of the SSN by both taxpayers.	2004	2009
2004	9-A3	Standardize procedures for information required from taxpayers.	2004	2009
2005	9-1	Conduct appropriate training for employees who determine whether to send cases to the SSA.	2005	2009
2005	9-2	Integrate awareness of identity theft into various training modules throughout the operating divisions and functions, so all employees are sensitive to this issue and can refer taxpayers to the appropriate IRS function.	2005	2011
2005	9-3	Use an electronic indicator on its master files to mark the accounts of taxpayers who have verified that they have been victims of identity theft.	2005	2008
2007	6-2	Develop a form that taxpayers can file when they believe they have been victims of identity theft. The instructions on the form should explain which steps the IRS will take and which steps the taxpayer should take (*e.g.*, obtaining an FTC affidavit) to restore the integrity of the taxpayer's account.	2007	2009
2007	6-7	Create a prefix for IRS numbers (IRSNs) or some other system so that it does not deny tax benefits to the rightful owner of the Social Security number (SSN). While assignment of IRSNs may be the only way to isolate the fraud taking place under an SSN, it is inequitable to assign the IRSN to identity theft victims and then deny tax benefits that depend on the SSN.	2007	2012
2011	3-10	Allow taxpayers to turn off the ability to file electronically.	2007	2012

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Mark identity theft victims' accounts as eligible for IP PINs as soon as the identities and addresses of the rightful SSN owner are verified, rather than after final resolution of the identity theft case.
2. Conduct a global account review upon receipt of a taxpayer's claim of identity theft in whichever IRS function serves as the taxpayer's first point of contact to ensure the case is appropriately routed and the all identity-theft issues are comprehensively resolved.
3. Retain the IPSU as the single point of contact with identity theft victims throughout the duration of their cases, unless the global account review indicates that there is only a single issue or tax year present in the case.
4. Move the IPSU out of the AM function, to afford it greater autonomy as it acts as the face of the IRS to identity theft victims.
5. Require the IPSU (or in the case of a single-issue case, the specialized function) to conduct final global account reviews on all identity theft cases.
6. Implement agreements between the IPSU and the various functions that work identity theft cases to set acceptable timeframes for completing the required actions and consequences for not meeting the timeframes.
7. Set a Level of Service goal for the Taxpayer Protection Unit equal to or greater than the Level of Service goal set for the main toll-free phone line.
8. Establish procedures that meet accelerated 90-day timeframes for determination of the true SSN owner and resolution of return-processing issues.
9. Insert into every agreement with state and local agencies an explicit clause that says that return information of an identity thief may be used only for prosecution of identity theft-related crimes (with no redisclosure to third parties).
10. Work with the Social Security Administration, the Office of Management and Budget, and the Justice Department to develop guidance that withholds the Death Master File from public release under a FOIA exemption for the limited period required to prevent the DMF's use in committing tax-related identity theft (which we believe to be two years).
11. Include TAS at all levels of identity theft program and procedural planning, including front-line teams, training development, guidance, and advisory and executive steering committees.

MSP #5 The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

RESPONSIBLE OFFICIALS

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DEFINITION OF PROBLEM

Tax return preparers sometimes alter return information without their clients' knowledge or consent in an attempt to obtain improperly inflated refunds or to divert refunds for their personal benefit. Often, the refunds are directed to an account in the preparer's control, leaving the taxpayer with no monetary benefit from the fraudulent filing but having to deal with the IRS in the aftermath. This type of misconduct creates significant challenges for the IRS, harms innocent taxpayers, and undermines trust in our tax system.

We have seen four primary fact patterns in the return preparer fraud cases that have come to the Taxpayer Advocate Service:

1. **Unauthorized filing.** A taxpayer visits a return preparer, but for some reason decides not to use this preparer and never authorizes a return filing. Later, the taxpayer attempts to file a return electronically (on his or her own, or through a different preparer), but the IRS rejects the return. The taxpayer then learns the IRS has already processed a return submitted by the first preparer, who directed the refund to an account not belonging to or under the control of the taxpayer.
2. **Altered return information — no additional refund due to taxpayer.** The taxpayer visits a preparer and authorizes him or her to file a return. The taxpayer reviews and approves for filing a copy of the "final return," but the preparer later alters it to increase the refund. The taxpayer receives the refund expected, while the preparer direct-deposits the excess to a different bank account.[1] The taxpayer later learns of the return preparer fraud and files a correct original return, but account issues remain.
3. **Altered return information — additional refund due to taxpayer.** Similar to (2), but the taxpayer only receives a portion[2] (or none[3]) of the refund he or she expected.

1 In some cases, the taxpayer receives the funds directly from the IRS by direct deposit; in other cases, the preparer has the entire amount (the taxpayer's correct refund plus the inflated refund) direct-deposited to the preparer, and then issues the taxpayer a check.

2 For example, suppose the taxpayer is entitled to a $500 refund. The preparer alters the data so the refund amount is $1,000. The preparer splits the refund to direct $600 to the preparer and $400 to the taxpayer, who does not receive the full refund to which he is entitled ($100 shortfall).

3 For example, suppose the taxpayer is entitled to a $900 refund. The preparer alters the tax data so that the amount is $1,900. The preparer splits the refund to direct $1,000 to the preparer and $900 to the taxpayer. The IRS stores only the information from the first bank account listed on Form 8888, *Allocation of Refund*. The refund is held for some reason beyond the first cycle when the split account information from Form 8888 is still in the system, so the refund is not split and the entire $1,900 refund is direct-deposited into the first account listed on Form 8888, which is the preparer's account.

4. **Misrouted direct deposit.** The taxpayer visits a preparer and authorizes a return filing. The taxpayer reviews and approves for filing a copy of the "final" return, but subsequently, the preparer alters the bank routing and account numbers; the return is otherwise accurate. The taxpayer never receives a refund, and learns the return filed by the preparer contained altered bank routing and account numbers.

Since 2000, the IRS has received the benefit of four separate legal opinions from its Office of Chief Counsel addressing return preparer misconduct.[4] Yet the IRS has declined to develop guidance to its employees on how to issue a replacement refund to victims, despite such guidance from its own Chief Counsel. Under current procedures, when the IRS is made aware of the return preparer misconduct, it is willing to "back out" the altered return filed by the preparer and process the correct original return once it is obtained from the taxpayer.[5] However, the IRS will not provide full relief to these victims by issuing a second refund in cases where the preparer absconded with the initial refund that the IRS issued when the falsified return was filed. Instead, victims of return preparer fraud are advised that because this is a civil matter between the taxpayer and the preparer, they should pursue recovery of their tax refunds from the return preparer without the assistance of the IRS. The IRS appears to be emphasizing budgetary concerns over legal principles.

According to former Commissioner Shulman, "e-file ensures people can file accurately and get refunds quickly" and "IRS e-file is now the norm, not the exception."[6] Clearly, the IRS is pushing taxpayers to e-file and use direct deposit. Yet we note that had the taxpayer requested a paper refund check, and it was improperly negotiated by the return preparer, the IRS could reissue a check to the taxpayer upon a timely filed claim.[7] The IRS should not treat similarly-situated taxpayers differently. Here, the group of taxpayers who are doing what the IRS has pushed them to do — namely, using return preparers (rather than using IRS-provided resources such as the Taxpayer Assistance Centers to file) and selecting the direct deposit option — are being treated unfairly.[8] Even as the IRS promotes electronic filing and payments, its policy of not issuing refunds to victims of return preparer misconduct creates a disincentive for taxpayers to e-file and request a direct-deposited refund.

Because of the IRS's refusal to develop procedures, the National Taxpayer Advocate issued guidance to TAS employees in May 2012,[9] directing Local Taxpayer Advocates to

4 *See* Field Service Advice 200038005 (June 6, 2000); IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

5 *See Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

6 IRS, IR-2011-4, *IRS e-file Launches Today; Most Taxpayers Can File Immediately* (Jan. 14, 2011).

7 *See* IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund (CFIF)* (Oct. 1, 2006).

8 For an in-depth discussion of the IRS's failure to provide all taxpayers with a free method to preparer and e-file their individual returns, see Most Serious Problem: *The IRS Is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Need to Be Done*, *infra*.

9 *See* Interim Guidance for Preparing Taxpayer Assistance Orders (TAOs) to Accounts Management Involving Return Preparer Fraud, TAS-13-0512-017 (May 23, 2012).

issue Taxpayer Assistance Orders (TAOs) on return preparer fraud cases.[10] In FY 2012, TAS issued 58 TAOs on these cases, of which 26 are elevated to the National Taxpayer Advocate — an unprecedented number on any issue. The average adjusted gross income (AGI) of the taxpayers involved in the elevated TAOs was less than $32,000. The refund sought by these taxpayers constituted, on average, 28 percent of their AGI. As of October 25, 2012, these cases were open in TAS for an average of 327 days (11 months) — and are still open![11]

ANALYSIS OF PROBLEM

Background

Under our current tax system, taxpayers are required by law to self-assess taxes and interact with the IRS. Given the complexity of the tax law, preparing and filing returns is a significant undertaking for many taxpayers. In fact, more than 80 percent of American households use paid preparers or tax software to help them prepare and file their tax returns.[12] With fewer Taxpayer Assistance Center resources available to help taxpayers prepare and file their returns, many feel pressure to enlist the services of a return preparer to meet their statutorily-mandated tax filing requirement.[13]

In response to the variety and prevalence of return preparer fraud, the IRS issued an alert on March 2, 2012, warning taxpayers about these schemes:[14]

- Fictitious claims for refunds or rebates based on false statements of entitlement to tax credits.
- Unfamiliar for-profit tax services selling refund and credit schemes to church members.
- Internet solicitations that direct taxpayers to toll-free numbers and then solicit Social Security numbers.
- Homemade flyers and brochures implying credits or refunds are available without proof of eligibility.
- Offers of free money with no documentation required.
- Promises of refunds for "Low Income — No Documents Tax Returns."

10 Internal Revenue Code (IRC) § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order upon a determination that a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.

11 TAS analysis of 26 return preparer fraud cases elevated to the National Taxpayer Advocate level as of October 25, 2012. Some averages were calculated with as few as 22 cases because not all data was available.

12 IRS, IR-2010-1, *IRS Proposes New Registration, Testing and Continuing Education Requirements for Tax Return Preparers Not Already Subject to Oversight* (Jan. 4, 2010).

13 *See* Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*, *infra*.

14 IRS, IR-2012-29, *Tax Scam Warning: Beware of Phony Refund Scheme Abusing Popular College Tax Credit; Senior Citizens, Working Families and Church Members Are Targets* (Mar. 2, 2012).

- Claims for the expired Economic Recovery Credit Program or for economic stimulus payments.
- Unsolicited offers to prepare a return and split the refund.
- Unfamiliar return preparation firms soliciting business from cities outside of the normal business or commuting area.

As tax preparers develop more ways to benefit from fraudulent returns, the list will undoubtedly continue to grow. There is certainly some overlap between identity theft and traditional refund fraud cases; some fact patterns encompass characteristics of more than one type of fraud.[15] For purposes of this discussion, we will focus on cases that fall into these four scenarios (described in detail in the problem statement):

1. Unauthorized filing;
2. Altered return information — additional refund due to taxpayer;
3. Altered return information — no additional refund due to taxpayer; and
4. Misrouted direct deposit.

IRS Guidance on Return Preparer Misconduct Is Incomplete

In July 2011, the National Taxpayer Advocate brought the issue of return preparer misconduct to IRS leadership's attention by elevating a series of TAOs to the Commissioner of the Wage and Investment (W&I) division. These TAOs, originally issued to the W&I Accounts Management (AM) function in December 2010, involved four taxpayers defrauded by the same preparer. Although the IRS has been aware of the need to provide relief to victims of return preparer misconduct since at least 2000, it had no such procedure in place at the time these TAOs were elevated.[16]

The National Taxpayer Advocate issued a Proposed Taxpayer Advocate Directive (TAD) to the Commissioner of W&I on June 13, 2011, to address this systemic issue.[17] This Proposed TAD directed W&I to establish procedures for adjusting the taxpayer accounts in instances where a preparer alters the return without the taxpayer's knowledge or consent. After receiving an unsatisfactory response to concerns raised about this matter in the Proposed TAD and the 2011 Annual Report to Congress,[18] the National Taxpayer Advocate issued a TAD to the W&I and Small Business/Self-Employed (SB/SE) division commissioners on

15 *See* Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*, *supra*; Most Serious Problem: *Despite Some Improvements, The IRS Continues to Harm Taxpayers by Unreasonably Delaying Processing of Refunds that Trigger Systemic Filters*, *infra*.

16 *See* Field Service Advice 200038005 (June 6, 2000).

17 Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a 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." IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). *See also* IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

18 *See* National Taxpayer Advocate 2011 Annual Report to Congress 59-60.

January 12, 2012.[19] This directive included suggestions for how the IRS could unwind the victims' accounts. While both commissioners have acknowledged their intent to comply with the substance of the TAD, they appealed the TAD in an effort to extend the time allowed to comply with the actions, even though the IRS already had over 12 years to develop procedures to assist these victims of fraud.

It took W&I until June 26, 2012, to provide its Accounts Management employees with interim guidance on resolving return preparer misconduct cases — and even then, the information was incomplete.[20] The National Taxpayer Advocate objected to the issuance of guidance on the grounds that it did not address many of the common fact patterns in our cases; for example, it does not provide procedures for scenarios 3 and 4 above.

In scenario 3, once the victim notifies the IRS of the misconduct, the IRS will ask the taxpayer to submit a correct return as intended to be filed and then will remove the altered return information from the taxpayer's account. However, the IRS will not issue the refund the taxpayer is due. Instead, the IRS informs the victim that preparer misconduct is a civil matter to be settled without its assistance. AM employees are instructed to suspend action on the case pending Chief Counsel guidance.

On October 17, 2012, the National Taxpayer Advocate issued a Proposed TAD to the W&I Commissioner, seeking procedures for issuing replacement refunds for victims of return preparer fraud.[21] Among other things, the Proposed TAD directed that W&I:

- Develop procedures to issue refunds to taxpayers who have had their direct deposit routing information altered by a third party without the taxpayer's consent; and
- Provide relief to taxpayers victimized by another individual who has prepared their return and committed fraud, even if the other individual does not fall within the definition of a "tax return preparer" receiving compensation (*e.g.*, family member, friend, neighbor, clergy).

The IRS Should Not Treat Similarly-Situated Taxpayers Differently

The IRS is pushing taxpayers to electronic filing, to both improve the accuracy of return processing and reduce costs.[22] Yet when taxpayers who are trying to comply with their obligations are victimized by return preparer misconduct, they are often left to deal with the aftermath with little help from the IRS. If the taxpayer requested a refund using *direct deposit*, the IRS will not reissue the refund to the taxpayer, even if the taxpayer has documented that he or she was a victim of return preparer misconduct. Instead, the IRS views

19 See Taxpayer Advocate Directive 2012-1 (*Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund*) (Jan. 12, 2012).

20 See Servicewide Electronic Research Program (SERP) Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012). This guidance was later incorporated into an interim guidance memorandum from the Director of AM on September 6, 2012.

21 See Proposed Taxpayer Advocate Directive 2012-5, *Establish procedures for issuing a replacement refund for victims of return preparer misconduct* (Oct. 17, 2012).

22 IRS, IR-2011-4, *IRS e-file Launches Today; Most Taxpayers Can File Immediately* (Jan. 14, 2011).

this as a civil matter between the victim and the return preparer or bank. In contrast, if a third party fraudulently endorses a victim's *paper refund check*, the FMS will investigate and may reissue a check to the taxpayer.[23]

The Check Forgery Insurance Fund (CFIF) legislation merely established a fund; it did not create a new authority for the IRS to replace fraudulently negotiated checks. This authority had always existed, so the designation of a source of funding is irrelevant to the discussion of whether the IRS should issue replacement funds to a taxpayer that never received the initial refund. In the case of a stolen direct deposit, the IRS Office of Chief Counsel previously has advised that, "the Service is legally permitted to reissue the refund to the taxpayer."[24] Therefore, we believe the IRS can and should establish a process by which a taxpayer can show that whoever wrongfully altered the bank account number on a return was not an authorized agent, and upon confirmation of these facts, the IRS should pay the refund to the taxpayer — regardless of whether the taxpayer requested a direct deposit or a check.

An Unauthorized Tax Return Should Not Be Treated as a Legitimate Return of the Taxpayer.

In *Beard v. Commissioner*,[25] involving a taxpayer who altered a Form 1040, *U.S. Individual Income Tax Return*, the Tax Court applied a four-part test to determine whether a document filed with the IRS qualifies as a "return" for tax purposes. Those requirements are that the document:

1. Purport to be a return;
2. Be signed under penalties of perjury;
3. Contain sufficient data to permit a tax to be calculated; and
4. Evince an honest and genuine endeavor to satisfy the requirements of tax law.

Beard has become the generally accepted test for determining the validity of a tax return.

The signature requirement derives from IRC § 6065, which states that generally, any return, declaration, statement, or other document required under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under penalties of perjury. This requirement authenticates the signed document and verifies its truthfulness.

In a typical return preparer misconduct case scenario, the preparer alters some information on the return after the taxpayer has authorized a prior version. The return submitted by the return preparer was not reviewed, authorized, or signed by the taxpayer under penalties

23 *See* IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund* (CFIF) (Oct. 1, 2006).

24 FSA 200038005 (June 6, 2000); *see also* 31 C.F.R. § 210.4(a)(1) (indicating that an agency that accepts an ACH authorization shall verify "the validity of the recipient's signature").

25 82 T.C. 766, 777-78 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

of perjury. It is not a valid return, as it fails the signature requirement of the *Beard* test, and thus should not be processed as a return of the taxpayer. However, under current procedures, the IRS considers this type of unsigned return to be an "authorized" return and will not issue a refund to a victim of return preparer fraud.

Relevant Chief Counsel Advice Permits the IRS to Issue Refunds to Victims of Return Preparer Misconduct.

Return preparer misconduct is not a new phenomenon. While W&I only recently issued partial guidance to its employees on how to assist victims, the IRS Office of Chief Counsel has provided advice on such situations dating as far back as 2000. These opinions provide the IRS ample advice to permit it to reissue refunds to victims of preparer misconduct in scenarios 3 and 4 described above.

In 2000, Chief Counsel issued advice addressing a situation where a taxpayer used the Volunteer Income Tax Assistance (VITA) program to file her return electronically, and the VITA volunteer subsequently changed the bank routing and account numbers to direct the refund into the account of a third party.[26] The Office of Chief Counsel concluded that there is "no legal impediment to reissuing a direct deposit refund" and noted that situations in which direct deposits are stolen are closely analogous to the stolen refund check situation, where there is a process for issuing a replacement.[27]

In 2003, Chief Counsel again addressed a situation where an e-filed return was altered without the taxpayer's knowledge, and declared that a return altered by a preparer *after* the victim has verified the accuracy of the return is a nullity.[28] In this 2003 memorandum, the Office of Chief Counsel analyzed the four-part test in *Beard*, and concluded that when the taxpayer is unaware of the alterations to the return, and the version that the taxpayer reviewed and approved is not what the preparer filed, the taxpayer did not sign that return under penalties of perjury. Consequently, the return filed by the preparer is a nullity and any assessment on the IRS's books and records relating to that return is invalid. Counsel advised that the taxpayer should file an *original* return (not an amended return) so the IRS can then adjust the taxpayer's Master File account to reflect the correct tax information.

In 2008, the Office of Chief Counsel once again looked at a situation where a refund was improperly directed to a preparer.[29] The memorandum makes clear that the IRS "can and should" adjust each affected taxpayer's account for any refund (or portion of one) illegally obtained by the preparer. The memorandum further advised that the IRS could bring an erroneous refund suit against the preparer to recover the amounts improperly obtained.

26 Field Service Advice 200038005 (June 6, 2000). While Field Service Advice is not binding and may not be cited as precedent, it does allow us some insight on how similar situations may be analyzed.

27 *See* IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund (CFIF)* (Oct. 1, 2006).

28 *See* IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003).

29 *See* IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008).

In 2011, the Office of Chief Counsel was again asked whether a return was valid if it was altered by a preparer to inflate income, deduction, credits, or withholding without the taxpayer's consent.[30] Again using the *Beard* analysis, Counsel concluded, "[a] tax return signed by a taxpayer that is altered by a tax return preparer without the taxpayer's knowledge and submitted to the IRS by the preparer is not a valid tax return."

In short: since 2000, the IRS has received four legal opinions from its Office of Chief Counsel addressing return preparer misconduct. Two of the opinions indicate that if a purported return fails the *Beard* test, it is a nullity.[31] Three of the opinions indicate that nullified returns should be backed out of the taxpayer's account.[32] And one of the opinions clearly indicates that there is no legal impediment to issuing the taxpayer his or her correct refund when he or she has not received it due to fraudulent misconduct by a preparer.[33] Thus, when reading all four opinions together, the IRS has received ample advice to permit it to reissue refunds to victims of return preparer misconduct in scenarios 3 and 4 described above.

Current Guidance Does Not Fully Address The Impact of Return Preparer Misconduct.

Under current guidance, when the IRS is made aware of the return preparer misconduct, it is willing to reverse the entries from the altered return filed by the preparer (*i.e.*, treat it as a nullity) and process the correct original return.[34] However, the IRS has declined to issue a replacement refund to victims, despite the guidance from the Office of Chief Counsel (discussed above).

The IRS draws a distinction between taxpayers who never authorized a preparer to file a return and those who authorized a filing but did not authorize the particular return the preparer filed. In the first situation, the guidance instructs AM employees to "Follow steps in *Accounts Resolution Initial Steps*" and issue a manual refund if the taxpayer did not receive the full refund.[35] The IRS considers this situation analogous to identity theft, where a third party steals a taxpayer's information and files a return claiming a refund. In the second situation, if the taxpayer is seeking a refund from the IRS, AM is instructed to suspend action on the case pending Chief Counsel guidance. The IRS considers the return filed to be "invalid" but not "unauthorized."

30 *See* IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

31 *See* IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

32 *See* IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

33 *See* Field Service Advice 200038005 (June 6, 2000).

34 *See Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

35 *Id.*

There should be no distinction between these two situations. In both instances, the return preparer filed a tax return that the taxpayer did not authorize. In many cases, the taxpayer is given a copy of the correct, authorized return, but the preparer later alters that return and files a fraudulent version. The fact that a taxpayer authorized the return preparer to file "a" return does not mean that the taxpayer authorized "the" return that was actually filed.

Well-established principles of agency law state that if an agent acts outside of the scope of the agency relationship, then this is an unauthorized act and thus not an action of the principal, unless later ratified (*i.e.*, approved) by the principal.[36] A return preparer altering portions of the tax return without the taxpayer's consent is an agent acting outside of the scope of the agency relationship — meaning the return as filed is not a valid return of the taxpayer and should be backed out of the victim's account. The IRS's current guidance ignores longstanding principles of agency law and leaves taxpayers with little recourse to recover their stolen direct deposit tax refunds.

Further, it seems intellectually dishonest for the IRS to treat the initial, altered return as a nullity when it does not require a payment to the taxpayer, yet refuse to fully process the taxpayer's correct original return when it requires an additional payment of a refund to the taxpayer. The IRS is willing to go halfway and back out the nullified return, but is unwilling to abide by the notion that the first return filed was not the return of the taxpayer when it is asked to issue a second refund. It is as though the IRS is employing a budgetary approach to legal and policy issues.

In an analogous situation, the IRS does make taxpayers whole by issuing a refund after initially processing a nullity. In this regard, when an identity thief files a tax return with falsified information purporting to be the taxpayer, the IRS initially processes the return and pays the refund to the thief. Later, when the victim provides sufficient documentation establishing the identity theft, the IRS moves the nullity to a temporary tax identification number (an IRSN) and accepts the correct original return from the victim. If a refund is associated with the return, the IRS pays it to the victim, regardless of whether it already paid a refund to the thief.

It makes little sense from a policy standpoint to treat victims of return preparer misconduct more harshly than victims of identity theft, when neither victim had any culpability. To be clear, we are not advocating that the IRS agree to hold the taxpayer harmless if there is any evidence that the taxpayer colluded with the return preparer to scam the government. However, the National Taxpayer Advocate disagrees wholeheartedly with the notion that by bringing the return preparer into the equation, the taxpayer automatically is assigned some degree of culpability.

36 *See* American Law Institute, Restatement (Third) of Agency § 6.05 (2006).

Altering the Bank Routing and Account Numbers Is Tantamount to Altering the Tax Return.

IRS procedures state that when the preparer altered the direct deposit information (rather than items of income, deduction, credits, etc.), AM should suspend action on the case pending Chief Counsel guidance.[37] The National Taxpayer Advocate does not believe the IRS should make a distinction on the basis of the *type of information* altered by the preparer. There appears to be no legal basis for arbitrarily deciding that the bank routing and account information is not material to, or part of, the tax return. In fact, to the taxpayer, the instructions on where to send the refund may be the most important part of the return. Seldom would a taxpayer authorize the filing of a return knowingly directing the refund to an account controlled by an unrelated third party who will abscond with the funds. As discussed above, the Office of Chief Counsel concluded in 2000 that the IRS can issue a second refund in a case where the bank routing and account numbers are altered by a third party.[38] To avoid further harm to taxpayers, the National Taxpayer Advocate requests that the IRS guidance incorporate this advice.

Taxpayers Must Be Able to Substantiate Return Preparer Misconduct.

The National Taxpayer Advocate recognizes that the IRS is concerned about the practical and financial effect of issuing refunds to victims after already paying out a refund with the altered return. Some taxpayers will certainly attempt to game the system, perhaps by colluding with a return preparer. We appreciate the need for the IRS to request documentation supporting the return preparer misconduct. It may be difficult for some taxpayers to meet the burden of proof the IRS requires. However, many are able to do so easily — some taxpayers have gone as far as file a police report against the return preparer. For years, the National Taxpayer Advocate has recommended that the IRS conduct a comprehensive consumer protection campaign, educating taxpayers about the need to get a copy of their tax return that is signed by their paid preparer.[39] The IRS's failure to conduct such a campaign robs taxpayers of their most persuasive evidence in the event of return preparer fraud.

The National Taxpayer Advocate urges the IRS to separate the problems of proof from its analysis of legal and policy issues. For taxpayers who provide sufficient documentation to support their claims, the IRS must quickly issue the refunds to which they are entitled and should not further victimize such taxpayers by depriving them of their tax refunds.

37 *See Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

38 Field Service Advice 200038005 (June 6, 2000).

39 *See* National Taxpayer Advocate 2011 Annual Report to Congress 431-432; National Taxpayer Advocate 2009 Annual Report to Congress 41-69; National Taxpayer Advocate 2008 Annual Report to Congress 503-512; National Taxpayer Advocate 2006 Annual Report to Congress 197-221; National Taxpayer Advocate 2005 Annual Report to Congress 223-237; National Taxpayer Advocate 2004 Annual Report to Congress 67-88; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2002 Annual Report to Congress 216-230; *Fraud in Income Tax Return Preparation*, Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

Scope of "Return Preparer Fraud" Should Be Expanded.

As mentioned above, taxpayers frequently use the services of return preparers to comply with their federal tax obligations. Often, these return preparers are professionals who are licensed and regulated. However, some taxpayers rely upon neighbors, co-workers, clergy, or family friends who may offer to help in filing their tax returns. Under current guidance, the IRS will not provide relief to taxpayers defrauded by preparers who are not in the business of preparing returns. As a result, many taxpayers who have been victimized by such preparers who are not "in the business of preparing returns" will not receive assistance from the IRS.

Rather than inquiring about the relationship between the taxpayer and the preparer, the IRS should instead focus on whether the taxpayer authorized the filing of the return that was submitted. We fully recognize the IRS's concern that some taxpayers with a non-business relationship with their return preparer may not truly be innocent victims of fraud. We do not suggest that the IRS relax its requirement that the taxpayer support his or her assertion that the return preparer filed an unauthorized return with appropriate documentation. But once the IRS is convinced that the return submitted was not the one authorized by the taxpayer, it does not matter whether the preparer was in the business of preparing tax returns.

Regulation of Return Preparers Should Give Taxpayers a Greater Level of Confidence in Choosing Trustworthy Practitioners.

The IRS began regulating return preparers in the 2012 filing season. Unenrolled preparers who prepare Form 1040 series returns must now take a competency test administered by the IRS Return Preparer Office.[40] Creating a class of certified return preparers is a very positive step toward combatting fraud.

In conjunction with the regular training and testing, a comprehensive communications plan targeting the most vulnerable taxpayers (*e.g.*, the elderly, those who speak English as a second language or are low income, college students) would be a worthwhile investment. By educating taxpayers on how to choose a qualified return preparer, the IRS can attempt to steer taxpayers away from the less scrupulous preparers. As noted above, the IRS should also remind taxpayers that a paid preparer is required to sign the tax return and provide the taxpayer with a copy of that signed tax return. These documents are the taxpayer's best defense against return preparer fraud, and the IRS's failure to educate taxpayers about how to protect themselves is, in the National Taxpayer Advocate's opinion, a gross dereliction of the government's duty to promote and protect the interests of its taxpayers.

40 The Return Preparer Office develops the questions, but the IRS selects a vendor to administer the test nationwide.

CONCLUSION

Return preparer misconduct is a growing problem for the IRS. Return preparer misconduct ties up IRS resources, drains the public fisc, and harms taxpayers. The IRS must do all it can to deter return preparer misconduct and develop comprehensive procedures to assist victims.

When a return preparer diverts a taxpayer's refund using an altered bank routing number and obtains the funds using direct deposit, the IRS will not issue a refund to the taxpayer. Instead, the IRS's position is that this is a civil matter between the victim and the return preparer or bank. At a time when the IRS is pushing taxpayers to electronic filing, its refusal to issue replacement refunds to those who requested direct deposit payment while agreeing to issue a replacement paper check is illogical and bad for tax administration.

Even as the IRS promotes electronic filing and payments, its policy of not issuing refunds to victims of return preparer misconduct creates a disincentive for taxpayers to e-file and request a direct deposited refund. In essence, the message the IRS is sending to taxpayer is this: Prepare and file your tax returns using a return preparer because it is almost impossible to keep up with the increasingly complex tax law, and utilize e-file and direct deposit to keep processing costs down and human errors to a minimum, but if the return preparer you choose is dishonest and absconds with your tax refund, you are on your own.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Develop comprehensive guidance providing full relief to victims of return preparer misconduct.
2. Conduct outreach and seek authorization to use appropriated funding for a comprehensive consumer safety information campaign for taxpayers, targeting the most vulnerable segments of the taxpayer population.

IRS COMMENTS

The IRS acknowledges that the perpetration of fraud by a tax return preparer is a very serious issue and one that presents unique challenges and difficult legal questions for the IRS. In addition, the issues have changed over time with new types of fraud developing as we work through this process. These types of cases are intensely factual in nature and involve varying forms of interaction between the IRS and taxpayers as well as third party return preparers. As a result, there are many new and varying factual situations to analyze, some of which have raised novel legal questions for our consideration. For these reasons, careful and thoughtful processing of these cases has taken longer than expected. We know that some taxpayers have been waiting a longer time than we would normally consider appropriate for resolution of their cases, and we hope that this will not continue going forward. As a steward of federal tax dollars, the IRS must ensure that legal requirements are satisfied before the government makes payments to taxpayers whose refunds may have been stolen

by a third party. The IRS is attempting to strike a balance in this area so that federal tax dollars are used appropriately.

The circumstances surrounding preparer fraud have been evolving. The IRS has devoted considerable time and resources in 2011 and 2012 toward the resolution of many of these issues. In April 2012, the IRS issued Servicewide Electronic Research Program (SERP) Alert 12A0238, *Contacts Regarding Specific Return Preparer Complaint Issues*, which provided internal guidance to assist taxpayers who contact the IRS claiming they have been victims of preparer fraud or misconduct. In conjunction with this new guidance, the IRS created a new form, Form 14157-A, *Tax Return Preparer Fraud or Misconduct Affidavit,* for taxpayers to use along with a Form 14157, *Return Preparer Complaint*, to submit their complaint and request account adjustments.

The IRS established a special unit in Memphis for Accounts Management to receive claims. Internal guidance to process claims was issued on those scenarios for which all legal issues have been resolved. On June 26, 2012, the IRS issued SERP Alert 12A0417, *Memphis AM ONLY-Return Preparer Misconduct Interim Guidance*. This SERP Alert, and subsequent internal guidance issued on September 6, 2012, provide internal guidance on how to resolve cases in which the taxpayer visits a return preparer but does not authorize that return preparer to file a tax return on their behalf. The guidance also addresses cases where the taxpayer authorized a tax preparer to file a tax return but the return is subsequently altered by the preparer without the consent of the taxpayer, provided the preparer did not misdirect a tax refund due and owing to the taxpayer. The IRS also issued guidance to Collection employees and posted it to the Technical Digest for all SB/SE compliance employees in July 2012.

The unresolved issues raised more recently present new and varying factual situations that need further legal analysis. Most of the remaining cases involve a third-party preparer, who has been authorized to file a tax return, but misappropriated tax refunds that were due and owing to the taxpayer. We have been actively coordinating with the Operating Divisions and Counsel to reach resolution. As a result, these types of cases are on hold awaiting guidance we expect to be forthcoming.

The National Taxpayer Advocate has recommended that the IRS conduct outreach and seek authorization to use appropriated funding for a comprehensive consumer safety information campaign for taxpayers, targeting the most vulnerable segments of the taxpayer population. The IRS website currently provides information to taxpayers on how to choose a Tax Return Preparer. See Tax Topic 254 on IRS.gov. It cautions taxpayers about unscrupulous preparers and provides a link regarding how to choose a tax preparer and how to interact with that preparer to avoid fraud (See hyperlink to IRS Tax Tip 2011-106). This page also provides a link to information on reporting suspected fraud (See "Where Do You Report Suspected Fraud?"). We agree that further education and outreach would be beneficial and will leverage our resources by engaging our partners and stakeholders.

In addition, the Return Preparer Office is continuing to phase in a multi-year plan that began in 2010 to regulate the paid preparer industry. Future steps of the plan include a public database of authorized preparers and a taxpayer education campaign. The database, which is scheduled to launch in 2013, will include a public listing of those individuals who are registered with the IRS, have met minimum competency and suitability requirements, and have appropriate credentials for preparing individual income tax returns for compensation. The taxpayer education campaign will include public service announcements and outreach and education about how to choose a paid preparer, including the types of credentials paid preparers should have, and how to use the database to find or check the credentials of a preparer.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate understands that the IRS has been placed in the difficult position of protecting the public fisc while processing over 140 million individual tax returns annually. We also recognize the IRS's desire to get a firm grasp of its legal obligations before developing procedures. However, the National Taxpayer Advocate believes that the IRS has already received sufficient guidance from the Office of Chief Counsel to proceed to make whole these victims of return preparer fraud.

Contrary to the IRS's assertion that "there are many new and varying factual situations to analyze," the IRS has known for at least 12 years — *more than a decade* — that some tax preparers have perpetrated fraud on their clients, including diversion of refunds. Since 2000, the IRS Office of Chief Counsel has issued several opinions that address similar situations. We have summarized the relevant conclusions, and believe that based on this guidance, the IRS is legally permitted to take all of the actions we have recommended.

The IRS has had 12 years to develop procedures to (1) back out the return information contained in the invalid or unauthorized return, (2) stop any collection action associated with a refund that the taxpayer never received, (3) process the taxpayer's true return, and (4) issue the proper refund to the taxpayer. While the IRS has finally developed interim procedures to address the first three steps, it stopped short of establishing a method of delivering refunds to the victims of preparer fraud — which is the most important aspect of case resolution from the victims' perspective. We do not believe that the IRS needs further guidance in order to assist the growing number of victims of return preparer fraud.

The IRS's inexcusable delay in acting on these cases and issuing guidance is inflicting real harm on real taxpayers. These are not mere cases where "some taxpayers have been waiting a longer time than we would normally consider appropriate for resolution of their cases" nor do they require such "careful and thoughtful processing" as to take over a decade to issue guidance. As we noted above, in FY 2012, TAS issued 58 TAOs on these cases,

of which 26 are elevated to the National Taxpayer Advocate. The average adjusted gross income (AGI) of the taxpayers involved in these 26 TAOs was less than $32,000, and the refund sought by these taxpayers constituted, on average, 28 percent of their AGI. In the face of these numbers, IRS inaction is callous.

As we go to press with this report, the total number of TAOs involving preparer fraud that have been elevated to the National Taxpayer Advocate is 60. To date, the Commissioner of the Wage and Investment Division has appealed ten of these TAOs, and the National Taxpayer Advocate is sustaining these TAOs to the Acting Commissioner of Internal Revenue. In each of these cases, the National Taxpayer Advocate has presented to the IRS significant documentary evidence of the preparer's actions and the harm sustained by the taxpayer, and laid out a road map of what corrective actions the IRS should take to remedy that harm. In these cases, there are few difficult policy calls to be made. A fraud has been committed, similar to what occurs when paper refund checks are misappropriated, and the IRS has the legal authority to make the taxpayer whole and seek restitution from the perpetrator. Never before has the National Taxpayer Advocate had to fight so hard for such a simple, basic issue of justice and fairness for taxpayers who were simply trying to comply with their tax filing obligations.

The IRS's ongoing failure to conduct a vigorous and extensive outreach and education campaign about preparer selection and protection against preparer fraud is unacceptable. Since 2002, the National Taxpayer Advocate has recommended that the IRS actively inform taxpayers who use paid preparers to ask for and obtain a copy of their returns, signed by that preparer, as required by law.[41] The IRS's own research demonstrates that the taxpayer populations most vulnerable to this type of fraud either do not have regular access to the Internet or do not actively use it for this type of information.[42] Thus, by failing to conduct an active and direct marketing campaign targeted to the most vulnerable populations and by merely putting cautionary information on its website, the IRS facilitates the very fraud that it should be warning against.

In October 2012, the National Taxpayer Advocate issued a proposed Taxpayer Advocate Directive (TAD) to the W&I Commissioner requesting that the IRS establish procedures for issuing refunds to victims of return preparer fraud, a copy of which immediately follows

41 See National Taxpayer Advocate 2002 Annual Report to Congress 216-230 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

42 *See generally* Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*, *infra*. *See also* Kathryn Zickuhr, Pew Internet, *Generations and Their Gadgets* (Feb. 2011), http://www.pewinternet.org/Reports/2011/Generations-and-gadgets.aspx; Kathryn Zickuhr, Aaron Smith, Pew Internet, *Digital Differences* (Apr. 2012), http://www.pewinternet.org/Reports/2012/Digital-differences.aspx; IRS Oversight Board, *2006 Service Channels Survey*; IRS, 2006 Market Segment Survey, *Many Unprotected from Fraudulent Tax Preparers*, http://press-room.lawyers.com/Many-Unprotected-from-Fraudulent-Tax-Preparers.html.

this discussion.[43] The division responded by saying it is meeting with senior leadership and Counsel in an attempt to reach resolution. Because the IRS has refused to develop such procedures, even though it has known since 2000 about the problems that return preparer fraud can thrust upon taxpayers, the National Taxpayer Advocate will issue a formal TAD in January 2013 directing the IRS to develop such procedures.

Recommendations

1. Develop comprehensive guidance providing full relief to victims of return preparer misconduct, including the issuance of a refund.
2. Conduct direct outreach and seek authorization to use appropriated funding for a comprehensive consumer safety information campaign for taxpayers, targeting the most vulnerable segments of the taxpayer population.

43 See Proposed Taxpayer Advocate Directive 2012-5, *Establish procedures for issuing a replacement refund for victims of return preparer misconduct* (Oct. 17, 2012). A TAD may be issued to (1) mandate administrative or procedural changes to improve the operation of a functional process, or (2) grant relief to groups of taxpayers (or all taxpayers) when its implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers. IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). *See also* IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009). IRM 13.2.1.6.1 (July 16, 2009) provides that in advance of issuing a TAD, the National Taxpayer Advocate attempts to work with and communicate with the owners of the process in order to correct the problem.

TAXPAYER ADVOCATE SERVICE
YOUR VOICE AT THE IRS

THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

Response Due: October 31, 2012

MEMORANDUM FOR Peggy Bogadi, Commissioner
Wage and Investment Division

FROM: Nina E. Olson /s/
National Taxpayer Advocate

SUBJECT: Proposed Taxpayer Advocate Directive 2012-5 (*Establish procedures for issuing a replacement refund for victims of return preparer misconduct*)

PROPOSED TAXPAYER ADVOCATE DIRECTIVE

Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a Taxpayer Advocate Directive (TAD). A TAD may be issued to (1) mandate administrative or procedural changes to improve the operation of a functional process, or (2) grant relief to groups of taxpayers (or all taxpayers) when its implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.[1] Internal Revenue Manual (IRM) 13.2.1.6.1 (July 16, 2009) provides that in advance of issuing a TAD, the National Taxpayer Advocate attempts to work with and communicate with the owners of the process in order to correct the problem. This Proposed TAD serves as a formal alert that I will issue a TAD if the IRS does not take the following concrete actions:

1) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to victims of return preparer fraud who are due a refund after they file a correct original return;
2) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to taxpayers who have had their direct deposit routing information altered by a third party without the taxpayer's consent;
3) within 30 days of the date of this Proposed TAD, provide relief to taxpayers victimized because another individual has prepared their return and committed fraud,

[1] Internal Revenue Manual (IRM) 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). *See also* IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

even if the other individual does not fall within the definition of a "tax return preparer" receiving compensation (*e.g.*, family member, friend, neighbor, clergy.);[2]

4) within 60 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, issue interim guidance to reflect these changes in procedures; and

5) within 90 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, revise the IRM to reflect these changes in procedures.

Please provide a written response to this Proposed TAD on or before October 26, 2012.

I. ISSUES

My office is seeing an increasing number of return preparer misconduct cases. Often, victims are individuals who are facing economic hardship and are in dire need of their tax refunds. I have written extensively about the need for the IRS to develop procedures to ensure that the tax accounts of the victims are appropriately adjusted and that the victims are not held responsible for the actions of these return preparers.[3]

Among our return preparer misconduct cases, there are four common scenarios.

(1) Unauthorized filing:

- Taxpayer (TP) visits a return preparer, but for whatever reason decides not to use this preparer and never authorizes a return filing;
- Later, TP attempts to file a return electronically (either on his/her own, or with assistance from a different preparer), but the IRS rejects the return;
- TP learns that the IRS has already processed a return submitted by the first preparer, who directed the refund to an account not belonging to, or under the control of, TP; and
- TP subsequently files a correct original return.

(2) Altered return information — no additional refund due to TP:

- TP visits a return preparer and authorizes a return filing;
- TP reviews and approves for filing a copy of the "final return," but subsequently, the preparer alters portions of this return to increase the refund amount;

2 It is my understanding that the IRS has refused to provide relief to a taxpayer victimized by someone who prepared the taxpayer's return who was not in the business of preparing returns.

3 See Proposed Taxpayer Advocate Directive 2011-1, *Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund* (June 13, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 59-60; Taxpayer Advocate Directive 2012-1 (*Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund*) (Jan. 12, 2012); *Identity Theft and Income Tax Preparation Fraud*, Hearing Before the House Judiciary Committee, Subcommittee on Crime, Terrorism, and Homeland Security, 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate).

- TP receives the refund amount expected, and the preparer directs the excess amount via direct deposit to different bank routing and account numbers[4]; and
- TP later learns of the return preparer fraud and files a correct original return.

(3) Altered return information — additional refund due to TP:

- Similar to (2), but TP only receives a portion[5] (or none[6]) of the refund amount he was expecting.

(4) Misrouted direct deposit:

- TP visits a return preparer and authorizes a return filing;
- TP reviews and approves for filing a copy of the "final" return, but subsequently, the preparer alters the bank routing and account numbers; the return is otherwise accurate; and
- TP never receives a refund, and learns that the return filed by the preparer contained altered bank routing and account numbers.

On June 26, 2012, Accounts Management (AM) issued interim guidance to its employees on resolving return preparer misconduct cases.[7] When my staff and I were asked to review a draft of the guidance, I objected to AM issuing this guidance, as it does not address some of the common fact patterns we see in our return preparer misconduct cases. For example, it does not provide procedures for scenarios 3 and 4 described above.

In scenario 3, once the victim notifies the IRS of the return preparer misconduct, the IRS will back out the altered return information from the taxpayer's account and ask the victim to submit a correct original return. Although a refund is due, the IRS will not issue a refund to the taxpayer. Instead, the IRS informs the victim that preparer misconduct is a civil matter to be settled without its assistance. AM employees are instructed to suspend action on the case pending Chief Counsel guidance.

4 In some cases, the taxpayer receives the amount directly from the IRS via direct deposit; in other cases, the preparer has the entire refund amount (taxpayer's correct refund plus the inflated refund) direct deposited to the preparer, and then issues the taxpayer a check.

5 For example, suppose TP is entitled to a $500 refund. The preparer alters the tax data so that the refund amount is $1,000. The preparer splits the refund on Form 8888, $600 to the preparer, $400 to TP. TP has not received the full refund amount to which he is entitled ($100 shortfall).

6 For example, suppose TP is entitled to a $900 refund. The preparer alters the tax data so that the refund amount is $1,900. The preparer splits the refund on Form 8888, $1,000 to the preparer, $900 to TP. IMF stores only the information from the first bank account listed on Form 8888. The refund is held for some reason beyond the first cycle when the split account information from Form 8888 is still in the system, so a split refund does not occur, and the entire $1,900 refund is direct-deposited into the first bank account listed on Form 8888, which in this example is the preparer's bank account.

7 *See* SERP Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012). This guidance was later incorporated into an interim guidance memorandum from the Director of AM on September 6, 2012. *See Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

In contrast, if a third party fraudulently endorses a victim's paper refund check, the IRS has procedures to re-issue a check to the taxpayer upon a timely filed claim.[8] However, if the return preparer diverts a victim's refund using altered bank routing and account numbers and obtains the funds using direct deposit (scenario 4), the IRS will not issue a refund to the taxpayer. Instead, the IRS's position is that it is a civil matter between the victim and the return preparer or bank.

II. PROCEDURAL HISTORY

TAS has previously discussed in depth the problems taxpayers encounter when they are the victims of return preparer misconduct. On January 12, 2012, I issued a TAD that covered the issue thoroughly.[9] In response to the TAD, on June 26, 2012, the Wage and Investment division (W&I) issued guidance that partially addressed my concerns, but failed to adequately provide relief for all victims of return preparer misconduct.[10]

III. ANALYSIS

Pursuant to the Beard Test, an Unsigned Return Is Not a Valid Return.

Beard v. Commissioner[11] involved a taxpayer who altered a Form 1040, *U.S. Individual Income Tax Return*. In *Beard*, the Tax Court applied a four-part test to determine whether a document filed with the IRS qualifies as a "return" for tax purposes. Those requirements are that the document: (1) purport to be a return; (2) be signed under penalties of perjury; (3) contain sufficient data to permit a tax to be calculated; and (4) evince an honest and genuine endeavor to satisfy the requirements of tax law. *Beard* has become the generally accepted test for determining the validity of a tax return.

The signature requirement derives from IRC § 6065, which states that generally, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under penalties of perjury. This requirement authenticates the signed document and verifies its truthfulness.

In a typical return preparer misconduct case scenario, the preparer alters some information on the tax return after the taxpayer has authorized a prior version of the return. The return submitted by the return preparer was not reviewed, authorized, or signed by the taxpayer

8 *See* IRM 21.4.2.4.15.3.1, Check Forgery Insurance Fund (CFIF) (Oct. 1, 2006).

9 Taxpayer Advocate Directive 2012-1 (*Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund*) (Jan. 12, 2012).

10 *See* SERP Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012). This guidance was later incorporated into an interim guidance memorandum from the Director of AM on September 6, 2012. *See Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

11 82 T.C. 766, 777-78 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

under penalties of perjury. It is not a valid return, as it fails the signature requirement of the *Beard* test.

Relevant Chief Counsel Advice Permits the IRS to Issue Refunds to Victims of Return Preparer Misconduct.

Return preparer misconduct is not a new phenomenon that the IRS is just now facing. While W&I only recently issued partial guidance to its employees on how to assist victims of return preparer misconduct, the IRS Office of Chief Counsel has provided advice on such situations dating as far back as 2000.

In 2000, the Office of Chief Counsel issued advice addressing a situation where a taxpayer used the Volunteer Income Tax Assistance (VITA) program to electronically file her tax return, and the VITA volunteer subsequently changed the bank routing and account numbers, with the result that the taxpayer's refund was directed into the account of a third party.[12] The Office of Chief Counsel concluded that there is "no legal impediment to reissuing a direct deposit refund." The Office of Chief Counsel noted that situations in which direct deposits are stolen are closely analogous to the stolen refund check situation, where there is a process for issuing a replacement refund check.[13]

In 2003, the Office of Chief Counsel again addressed a situation where an electronically filed tax return was altered without the taxpayer's knowledge, and declared that a return altered by a preparer *after* the victim has verified the accuracy of the return is a nullity.[14] In this 2003 memorandum, the Office of Chief Counsel analyzed the four-part test set forth in *Beard*, and concluded that when the taxpayer is unaware of the alterations to the return and the version that the taxpayer reviewed and approved is not what the preparer filed with the IRS, the taxpayer did not sign that return under penalties of perjury. Consequently, the return filed by the preparer is a nullity and any assessment on the IRS's books and records relating to that return is invalid. Counsel advised that the taxpayer should file an *original* return (not an amended return) so that the IRS can then adjust the taxpayer's Master File account to reflect the correct tax information.

In 2008, the Office of Chief Counsel once again looked at a situation where a refund was improperly directed to a preparer.[15] The memorandum makes clear that the IRS "can and should" adjust each affected taxpayer's account for any refund (or portion of one) illegally obtained by the preparer. The memorandum further advised that the IRS could bring an erroneous refund suit against the preparer to recover the amounts improperly obtained.

12 Field Service Advice 200038005 (June 6, 2000). While Field Service Advice is not binding and may not be cited as precedent, it does allow us some insight on how similar situations may be analyzed.

13 *Id. See also* IRM 21.4.2.4.15.3.1, Check Forgery Insurance Fund (CFIF) (Oct. 1, 2006).

14 *See* IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003).

15 *See* IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008).

In 2011, the Office of Chief Counsel was again asked whether a return that was altered by a return preparer to inflate items of income, deduction, credits, or withholding without the taxpayer's consent was a valid tax return.[16] Again utilizing the *Beard* analysis, Counsel concluded that "[a] tax return signed by a taxpayer that is altered by a tax return preparer without the taxpayer's knowledge and submitted to the IRS by the preparer is not a valid tax return."

Since 2000, the IRS has received four legal opinions from its Office of Chief Counsel addressing return preparer misconduct. Two of the opinions indicate that if a purported return fails the *Beard* test, it is a nullity. Three of the opinions indicate that nullified returns should be backed out of the taxpayer's account. And one of the opinions clearly indicates that there is no legal impediment to issuing the taxpayer his or her correct refund when he or she hasn't received it due to fraudulent misconduct by a return preparer. Thus, when reading all four opinions together, the IRS has received ample advice to permit it to reissue refunds to victims of return preparer misconduct in scenarios 3 and 4 described above.

Current Guidance Does Not Fully Address Impact of Return Preparer Misconduct. Under current guidance,[17] when the IRS is made aware of the return preparer misconduct, it is willing to back out the altered return filed by the preparer (*i.e.*, treat it as a nullity) and process the correct original return once it is obtained from the taxpayer. However, the IRS has declined to issue a replacement refund to victims, despite the guidance it has received from the Office of Chief Counsel (discussed above).

The IRS makes a distinction between (1) taxpayers who never authorized a return preparer to file a return, and (2) taxpayers who authorized a return preparer to file a return but did not authorize the particular return filed by the return preparer. In the first situation, the interim guidance instructs AM employees to "Follow steps in *Accounts Resolution Initial Steps*" and issue a manual refund if the taxpayer did not receive the full refund.[18] My understanding is that the IRS considers this situation to be analogous to identity theft where a third party steals a taxpayer's information and files a return claiming a refund. In the second situation, if the taxpayer is seeking a refund from the IRS, AM is instructed to suspend action on the case pending Chief Counsel guidance. The IRS considers the return filed to be "invalid" but not "unauthorized."

There should be no distinction between these two situations. In both instances, the return preparer filed a tax return that the taxpayer did not authorize. In many cases, the taxpayer is given a copy of the correct return that he or she authorized the return preparer to file, but the return preparer alters information on the return and ends up filing a different

16 *See* IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011)

17 *See Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

18 *Id.*

version of the return. The fact that a taxpayer authorized the return preparer to file "a" return does not mean that the taxpayer authorized "the" return that was actually filed.

Well-established principles of agency law state that if an agent acts outside of the scope of the agency relationship, then it is an unauthorized act and thus not an action of the principal, unless later ratified by the principal.[19] A return preparer altering portions of the tax return without the taxpayer's consent is an agent acting outside of the scope of the agency relationship — meaning the return as filed is not a valid return of the taxpayer and should be nullified. The taxpayer should be given the opportunity to file a valid return and receive the full refund associated with that return. The interim guidance ignores longstanding principles of agency law and leaves taxpayers with little recourse to recover their stolen direct deposit tax refunds.

The IRS may argue that it reasonably relied upon the apparent authority of the return preparer, and acted to its detriment in processing the refund. I agree that the doctrine of apparent authority is necessary to protect a helpless third party. But I would hardly characterize the IRS as a helpless party in such a transaction; *the taxpayer is the party that requires protection.* Under our current tax system, taxpayers are required by law to self-assess taxes and interact with the IRS. Given the complexity of the tax law, preparing and filing returns is a significant undertaking for many taxpayers. In fact, more than 80 percent of American households use paid preparers or tax software to help them prepare and file their tax returns.[20] With less Taxpayer Assistance Center resources available to help taxpayers prepare and file their tax returns, many feel pressure to enlist the services of a return preparer to meet their statutorily-mandated tax filing requirement. The filing of one's taxes is an entirely different situation than the typical contractual relationship under which apparent authority is exercised.

Further, it seems intellectually dishonest for the IRS to treat the initial, altered return as a nullity when it does not require a payment to the taxpayer, yet refuse to fully process the taxpayer's correct original return when it requires an additional payment of a refund to the taxpayer. The IRS is willing to go halfway and back out the nullified return, but it is unwilling to abide by the notion that the first return filed was not the return of the taxpayer when it is asked to issue a second refund. I have not been provided an adequate explanation to support this decision. It is as though the IRS is employing a budgetary approach to legal and policy issues.

In an analogous situation, the IRS does make taxpayers whole by issuing a refund after initially processing a nullity. In this regard, when an identity thief files a tax return with falsified information purporting to be the taxpayer, the IRS initially processes the return and pays out the refund to the identity thief. Later, when the identity theft victim provides

19 *See* American Law Institute, Restatement (Third) of Agency § 6.05 (2006).

20 IRS, IR-2010-1, *IRS Proposes New Registration, Testing and Continuing Education Requirements for Tax Return Preparers Not Already Subject to Oversight* (Jan. 4, 2010).

sufficient documentation establishing the identity theft, the IRS moves the nullity to a temporary tax identification number (an IRSN) and accepts the correct original return from the victim. If there is a refund associated with the return, the IRS pays the refund to the identity theft victim, regardless of whether it paid a refund to the identity thief initially.

It makes little sense from a policy standpoint to treat victims of return preparer misconduct more harshly than victims of identity theft, when neither victim had any culpability in the refund misconduct scam. To be clear, I am not advocating that the IRS agree to hold the taxpayer harmless if there is any evidence that the taxpayer colluded with the return preparer to scam the government. However, I disagree wholeheartedly with the notion that by bringing the return preparer into the equation, the taxpayer automatically is assigned some degree of culpability.

Altering the Bank Routing and Account Numbers Is Tantamount to Altering the Tax Return.

The interim guidance on return preparer misconduct provides that in situations where the preparer altered the direct deposit information (rather than items of income, deduction, credits, etc.), AM should suspend action on the case pending Chief Counsel guidance. I do not believe there should be a distinction made on the basis of the *type of information* altered on the return by the return preparer. I see no legal basis for arbitrarily deciding that the bank routing and account information is not material to, or part of, the tax return. In fact, to the taxpayer, the instructions on where the refund payment is to be sent may be the most important part of the tax return. No taxpayer would authorize the filing of a return knowingly directing the refund to an account controlled by a third party over which the taxpayer has no control. As discussed above, the Office of Chief Counsel issued advice in 2000 concluding that the IRS is permitted to issue a second refund in a case where the bank routing and account numbers are altered by a third party on a taxpayer's return.[21] To avoid further harm to taxpayers, I request that the IRS guidance incorporate this advice.

I note that had the return preparer diverted a victim's refund by requesting a paper refund check, the IRS has procedures to re-issue a check to the taxpayer upon a timely filed claim.[22] The Financial Management Service, upon determining that the taxpayer was not involved in the negotiation of the check, will issue a replacement to the taxpayer and charge the Check Forgery Insurance Fund (CFIF).[23] The CFIF is a revolving fund created by a statute that specifically refers to a "check," with longstanding rules and regulations that do not contemplate electronic payments.[24]

21 Field Service Advice 200038005 (June 6, 2000). While Field Service Advice is not binding and may not be cited as precedent, it does allow us some insight on how similar situations may be analyzed.

22 *See* IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund* (CFIF) (Oct. 1, 2006).

23 A settlement check is a replacement check based on the Form 1133 claim issued by FMS to replace the original check. IRM 21.4.2.4.13 (Dec. 20, 2010).

24 Congress established the CFIF by law in 1941, before the advent of electronic checks. Pub. L. No. 77-310, 55 Stat. 777 (Nov. 21, 1941). While unrelated regulations provide for electronic checks, the CFIF regulations and rules contemplate forgery of signatures on paper.

The CFIF legislation merely established a fund; it did not create a new authority for the IRS to replace fraudulently negotiated checks. This authority had always existed, so the designation of a source of funding is irrelevant to the discussion of whether the IRS should issue replacement funds to a taxpayer that never received the initial refund. In the case of a stolen direct deposit, the IRS Office of Chief Counsel previously has advised that, "the Service is legally permitted to reissue the refund to the taxpayer."[25] Therefore, I believe the IRS can and should establish a process by which a taxpayer can show that whoever wrongfully altered the bank account number on a return was not an authorized agent, and upon confirmation of these facts, the IRS should pay the refund to the taxpayer — regardless of whether the refund was requested via direct deposit or by check.

Taxpayers Must Be Able to Substantiate the Occurrence of Return Preparer Misconduct.

I recognize that the IRS is concerned about the practical and financial effect of issuing refunds to victims after already paying out a refund initially with the altered return. There will certainly be taxpayers attempting to game the system, perhaps by colluding with a return preparer. I appreciate the need for the IRS to request documentation substantiating the return preparer misconduct. It may be difficult for some taxpayers to meet the burden of proof the IRS requires. However, many are able to easily — some taxpayers have gone as far as file a police report against the return preparer.

I urge the IRS to separate the problems of proof from its analysis of legal and policy issues. For those taxpayers who are able to provide sufficient documentation supporting their claim, the IRS must act quickly to issue the refunds to which they are entitled. We should not further victimize such taxpayers by depriving them of their tax refunds.

Scope of "Return Preparer Fraud" Should Be Expanded.

As I mentioned above, taxpayers often use the services of return preparers to comply with their federal tax obligations. Often, these return preparers are professionals who are licensed and regulated. However, some taxpayers rely upon the services of neighbors, co-workers, clergy, or family friends that may offer to assist in filing their tax returns. Under current guidance, the IRS will not provide relief to taxpayers who have been defrauded by tax return preparers who are not in the business of preparing returns. As a result, many taxpayers who have been victimized by return preparers who are not "in the business of preparing returns" will not receive assistance from the IRS.

Rather than inquiring about the relationship between the taxpayer and the return preparer, the IRS should instead focus on whether the taxpayer authorized the filing of the particular return that was submitted for processing. I fully recognize the IRS's concern that some taxpayers with a non-business relationship with their return preparer may not

[25] FSA 200038005 (June 6, 2000); *see also* 31 C.F.R. § 210.4(a)(1) (indicating that an agency that accepts an ACH authorization shall verify "the validity of the recipient's signature").

truly be innocent victims of fraud. I do not suggest that the IRS relax its requirement that the taxpayer support with appropriate documentation his or her assertion that the particular return filed by the return preparer was an unauthorized return. But once the IRS is convinced that the return submitted by the return preparer was not the one authorized by the taxpayer, it matters not whether the return preparer was in the business of preparing tax returns.

IV. CONCLUSION

According to Commissioner Shulman, "e-file ensures people can file accurately and get refunds quickly" and "IRS e-file is now the norm, not the exception."[26] At a time when the IRS is pushing taxpayers to electronic filing, as a way to both improve the accuracy and reduce the costs of return processing, its refusal to issue replacement refunds to those who requested direct deposit payment while agreeing to issue a replacement paper check is illogical and bad for tax administration.

When taxpayers who are trying to comply with their tax filing obligations are victimized by return preparer misconduct, such victims are often left to deal with the aftermath with little help from the IRS. I suspect that victims of return preparer misconduct take little solace in the fact that, as the IRS is quick to suggest, they might be able to track down the return preparer and file a civil suit to obtain their tax refund money. Even as the IRS promotes electronic filing and payments, its policy of not issuing refunds to victims of return preparer misconduct creates a disincentive for taxpayers to e-file and request a direct deposited refund.

V. REQUESTED ACTIONS

For these reasons, I am issuing this Proposed TAD to protect the rights of taxpayers and prevent undue burden. In light of the significant harm taxpayers are suffering as a result of the IRS's inability to develop a process for providing relief to these victims, I request that you:

1) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to victims of return preparer fraud who are due a refund after they file a correct original return;
2) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to taxpayers who have had their direct deposit routing information altered by a third party without the taxpayer's consent;
3) within 30 days of the date of this Proposed TAD, provide relief to taxpayers victimized because another individual has prepared their return and committed fraud,

[26] IRS, IR-2011-4, *IRS e-file Launches Today; Most Taxpayers Can File Immediately* (Jan. 14, 2011).

even if the other individual does not fall within the definition of a "tax return preparer" receiving compensation (*e.g.*, family member, friend, neighbor, clergy.);

4) within 60 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, issue interim guidance to reflect these changes in procedures; and

5) within 90 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, revise the IRM to reflect these changes in procedures.

Attachments:

(1) Taxpayer Advocate Directive 2012-1 (*Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund*) (Jan. 12, 2012)
(2) SERP Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012)
(3) Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY), WI-21-0812-02 (Sept. 6, 2012).
(4) IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of* a *Return*, PMTA 2011-20 (June 27, 2011)
(5) IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008)
(6) IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003)
(7) Field Service Advice 200038005 (June 6, 2000)

cc: w/ attachments: Steve Miller, Deputy Commissioner, Services and Enforcement

MSP #6

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Jodi Patterson, Director, Return Integrity and Correspondence Services

DEFINITION OF PROBLEM

The IRS's Questionable Refund Program (QRP), which detects and prevents false refunds, is an integral part of the IRS revenue protection program. The National Taxpayer Advocate first identified problems with the administration of the QRP in her 2005 Annual Report to Congress.[1] The report revealed that the data mining selection process used to identify questionable returns was flawed, resulting in too many legitimate refunds being frozen. The affected taxpayers waited inordinate amounts of time for their refunds while the IRS attempted to verify their returns.[2] Many of these taxpayers would never receive their refunds, as their accounts were among the 240,000 with permanent (hard) refund freezes languishing in the QRP inventory.[3]

Following the National Taxpayer Advocate's report and subsequent congressional and public criticism, the IRS agreed to dramatically alter the QRP, including moving it out of the Criminal Investigation (CI) unit and into the Wage and Investment (W&I) division in October 2009, under the Accounts Management Taxpayer Assurance Program (AMTAP). However, many of the problems we identified in 2005 persist today.

- In the second quarter of fiscal year (FY) 2012, the IRS reported that QRP inventory had increased three-fold over the previous year.[4] As a result, the IRS has not been able to work this increased inventory within 70 calendar days, as agreed to between the National Taxpayer Advocate and Criminal Investigation in 2006, and began to apply hard freezes on these accounts.
- In FY 2012, AMTAP imposed a "hard freeze"[5] on more than 142,000 returns because it could not complete the verification within the allotted time, not because the returns

1 See National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*).

2 The IRS uses third-party data in an attempt to verify wages and withholding reported on returns claiming refunds.

3 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2007-10-076, *Actions Have Been Taken to Address Deficiencies in the Questionable Refund Program; However, Many Concerns Remain, with Millions of Dollars at Risk* 11 (May 2007).

4 Wage and Investment Division (W&I) Business Performance Review, 2nd Quarter 2012 (May 18, 2012).

5 A hard freeze (designated with transaction code 570) indicates an additional liability is pending and keeps the module from refunding or offsetting credit out (transferring funds to other federal debt owed by the taxpayer). A hard freeze may be released manually or when the refund request has been disallowed.

show "badges of fraud" or are otherwise suspect.[6] In other words, AMTAP is using a hard freeze — normally designated for accounts in which potentially fraudulent activity has been "verified" — as an inventory management tool, without sufficient analysis of relative risk.

- TAS receipts of AMTAP cases — one indicator of flawed IRS procedures — rose approximately 468 percent since FY 2010, from 3,171 case receipts in FY 2010 to 18,012 in FY 2012. AMTAP cases currently constitute 8.2 percent of all TAS case receipts and are the second most common issue in TAS casework.[7]
- TAS is increasingly receiving cases from taxpayers who are experiencing crippling economic burden because of IRS AMTAP delays.
- Seventy percent of all taxpayers who sought TAS help with the refund freezes in 2012 were experiencing some kind of financial harm as a result of IRS actions (or inaction), compared to 38 percent in 2010.[8]
- A representative sample of TAS wage verification cases closed in 2012 found that 86 percent of these taxpayers were facing potential adverse impact.[9]
- Seventy percent of these taxpayers with hardships received full relief (with another two percent receiving partial relief).[10]
- In the same representative sample of TAS pre-refund cases, 53 percent of the taxpayers claimed and received the Earned Income Tax Credit (EITC). These taxpayers waited more than three months for a median refund of $5,175. The refunds comprised 38 percent of their Adjusted Gross Income (AGI).[11]

The National Taxpayer Advocate appreciates the need for revenue protection, but believes there should be no conflict between protecting revenue and providing due process to taxpayers whose returns are being questioned.

Despite improvements to the AMTAP program, the National Taxpayer Advocate remains extremely concerned with AMTAP's continued lack of urgency with respect to assisting

6 Email from AMTAP (May 10, 2012). The National Taxpayer Advocate had requested IRS extend the "soft freeze" on these unworked accounts instead of placing a hard freeze on them, which would retain pressure on the IRS to work these cases quickly. The IRS stated that "systems limitations" prevent it from extending soft freezes. *Id*.

7 TAS Business Performance Review, 4th Qtr. 2010 thru 4th Qtr. 2012. TAS started using Primary Issue Code (PIC) 045 on March 24, 2010, to identify AMTAP pre-refund cases. FY 2010 PIC 045 receipts: 3,171; FY 2011 PIC 045 receipts: 21,286; FY 2012 PIC 045 receipts: 18,012. TAMIS/Business Objects (BOBJ) Report FY Receipts 2010, 2011, 2012.

8 TAMIS/Business Objects (BOBJ) Report FY Receipts 2010, 2011, 2012.

9 TAS 2012 analysis of Compliance Data Warehouse (CDW) data from the Individual Returns Transaction File of 474 closed TAS cases with PIC 045 (Pre-Refund Wage Verification) pulled on October 5, 2012 (hereinafter "TAS 2012 Study"). This was a representative sample of TAS cases and had a confidence level of 95 percent.

10 *See* TAS 2012 Study.

11 *See id*. There were 241 EITC taxpayers in our random sample of 494 PIC 045 cases. The median AGI was $14,101, median refund was $5,175, and median refund hold was 99 days.

taxpayers ensnared by IRS refund fraud filters. This disregard for taxpayers' rights is evidenced by the IRS's decision to:

1. Auto-void certain suspicious returns without notifying the taxpayer;[12]
2. Extend refund holds on returns that do not exhibit badges of fraud or are otherwise suspect (*i.e.*, using refund freezes as an inventory control measure); and
3. Not effectively track the transferal of cases to the Exam function from AMTAP, thereby delaying notification of taxpayers and resolution of accounts, and imposing additional burden on taxpayers and IRS employees alike.

Finally, the IRS's failure to adequately address taxpayer service needs within this program causes:

- Increased inventory levels without the corresponding resources needed to resolve cases timely, as shown by the continued imposition of hard freezes;
- More taxpayers with legitimate refund claims being ensnared by filters each year;
- Frustrated taxpayers forced to deal with phone assistors who cannot advise them about the status of their refunds; and
- Confusion among IRS functions about whose responsibility it is to resolve cases.

ANALYSIS OF PROBLEM

Background

In 2005, the National Taxpayer Advocate identified the IRS's use of permanent refund freezes in connection with questionable refund claims as the most serious problem facing taxpayers. A 2005 TAS study of refund freeze cases in which taxpayers sought TAS assistance determined that approximately 66 percent of these taxpayers ultimately received the full amounts they originally claimed on their returns and over 80 percent received at least partial refunds,[13] but only after waiting a median time of more than eight and one-half months.[14] When we again analyzed AMTAP cases in TAS inventory in 2011, we found approximately 78 percent of taxpayers who came to TAS ultimately received the full relief.[15] The median refund amount was $4,062, which the taxpayer waited more than six months to receive.[16]

12 When a return is auto-voided, the IRS does not process the return; rather, the IRS archives the return, either electronically in Tax Return Data Base (TRDB) or on paper in Files. If the taxpayer later comes forward and confirms his/her identity as a legitimate taxpayer with a filing obligation, the IRS will retrieve the return and process it as of the original filing date. All returns being suspected as part of the Operation Mass Mailing scheme are auto-voided.

13 *See* National Taxpayer Advocate 2005 Annual Report to Congress vol. 2, 2 (*Criminal Investigation Refund Freeze Study*).

14 *See id.* at 15.

15 *See* TAS analysis of CDW data from the Individual Returns Transaction File of 373 closed TAS cases with PIC 045 (Pre-Refund Wage Verification) and PIC 425 (Stolen Identity) with secondary issue code (SIC) 045 cases pulled on October 11, 2011 (hereinafter "TAS 2011 Study"). This was a representative sample of TAS cases and had a confidence level of 95 percent.

16 *See* TAS 2011 Study.

AMTAP's main objective is to identify and stop fraudulent refunds before they are paid out. AMTAP uses the Electronic Fraud Detection System (EFDS) to screen, score, and select returns suspected of fraud for review. The IRS updates its screens each year based on its experience with prior years' returns. Current-year returns requesting refunds are passed through the updated knowledge base and scored for likelihood of fraud. Returns that are flagged are diverted for further inspection before the IRS issues any refund.

The IRS states that the EFDS filters are 93 percent accurate in detecting potentially fraudulent returns.[17] With EFDS selecting nearly one and one-half million returns, even if we take the 93 percent accuracy rate at face value, we note that the screens impact over 102,000 taxpayers with legitimate refund claims.[18] Our continued case reviews reveal that a significant percentage of taxpayers who come to TAS for assistance with their refund holds have received full relief.

When EFDS selects a return for screening, it systemically holds the refund for 11 weeks.[19] At that time, AMTAP sends a letter informing the taxpayer that income, withholding, or tax credits are being "reviewed" and that the IRS is holding the refund for a more thorough assessment.[20] The 11 weeks allows the IRS time for wage and withholding verification.

One method AMTAP uses to verify return information during this review period is to compare it with the Information Returns Master File (IRMF). The IRMF contains third-party information such as wage and withholding reported on Forms W-2, *Wage and Tax Statement*, and most Forms 1099, *U.S. Information Return*.[21] If AMTAP cannot initially verify wage and withholding documents systemically via the IRMF, it moves on to a manual "verification" process. AMTAP employees attempt to contact the employer to verify the amounts reported on the return by disc, fax, or phone.[22] If AMTAP verifies the wages and withholding as accurate, the IRS will release the refund.

If AMTAP cannot verify the information through internal records or by contacting the employer, the IRS sends the taxpayer a notice or a letter requesting documentation (*e.g.*, pay

17 *See* W&I response to TAS information request (Aug. 28, 2012).

18 There were 1,452,549 cases selected for verification in 2012 through October 15. Seven percent, or 102,236, were not verified "bad." *See* W&I response to TAS information request (Nov. 19, 2012).

19 The temporary freeze is automated within EFDS, and is evidenced by TC 971-134 on the taxpayer's account. IRM 21.9.1.2.3 (Mar. 1, 2012).

20 Notice CP 05, *Information Regarding Your Refund*.

21 Under present law, issuers who file these forms electronically have until March 31 to file them with the government. Issuers send Forms 1099 directly to the IRS and Forms W-2 directly to the Social Security Administration (SSA), which in turn sends information extracted from the forms to the IRS each week, starting in late March. Internal Revenue Code (IRC) §§ 6051(a), 6049(a), 6042(a); *see IRS Instructions for Forms W-2 and W-3, Wage and Tax Statement and Transmittal of Wage and Tax Statements;* Social Security Administration, *Employer W-2 Filing Instructions & Information, available at* http://www.ssa.gov/employer/gen.htm (last visited Oct. 24, 2012). For a more detailed discussion of third- party information reporting and its uses, see Status Update: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System, infra*.

22 IRM 21.9.1.8(1) (May 4, 2012). The IRS employs several methods to contact employers for verification of wages, adhering to the employer preference if one exists. Letters are sent annually to certain large employers, requesting them to provide wage information on a computer disc. Requests for verification are automatically generated by fax; phone calls are made based on employer preference.

stubs, Forms W-2), and extends the refund hold.[23] AMTAP will also convert the hold from a temporary (soft) hold to a permanent (hard) one when it has not completed the verification process before the temporary hold expires.[24]

AMTAP Employees Given Early Access to Information Reporting Data.

Traditional manual verification of wage information is a time-consuming process, making it difficult for AMTAP to meet the 70-day response time promised to taxpayers. One of the tools used to verify wage withholding on questionable returns is the Information Returns Processing Transcript Requests (IRPTR) command code.[25] Historically, current tax year IRPTR information was not available until mid-May of the following year.

The National Taxpayer Advocate has previously noted that taxpayers would benefit greatly if the IRS could find a way to utilize IRPTR data in real time, or even a month earlier.[26] Beginning in the 2012 filing season, AMTAP employees were given access to IRPTR in March, which enabled AMTAP to systemically verify wages and withholding on almost 530,000 questionable refund claims (34 percent of all returns verified) much more efficiently.[27]

Lack of Resources and Increasing Inventory Selection Are Reminiscent of Problems Identified in 2005.

The old adage that history repeats itself appears to apply to the QRP, regardless of whether AMTAP or CI is responsible for the program. Even though AMTAP staffing has increased, it appears the growth is not sufficient to handle the volume of cases the program selects for screening and verification, a number that rises each year.[28] In FY 2012, AMTAP selected over 1.4 million information documents for verification, compared to just over 430,000 in 2010.[29] This represents a 238 percent increase over the last three years. Thus, it is not surprising that AMTAP cannot complete the verification process in the agreed-upon time.[30]

23 IRM 21.9.1.8(1) (May 4, 2012). Letter 4115 requests income documentation from the taxpayer/employee (*e.g.*, copies of checks, bank statements, pay statements, check stubs, and employer letters).

24 Email from AMTAP analyst (Sept. 28, 2011).

25 The IRPTR command code allows IRS employees to request either online or hardcopy Information Returns Processing transcripts from the Information Returns Master File. IRM 2.3.35.1 (Aug. 1, 2003).

26 *See* National Taxpayer Advocate 2011 Annual Report to Congress 32, 47.

27 As of June 30, 2012, IRS used IRPTR to verify 529,842 returns, 34 percent of the total returns verified as of that date. *See* W&I response to TAS information request (Aug. 28, 2012).

28 AMTAP was staffed with 336 full-time equivalents in 2010 and 477 full-time equivalents in 2012. *See* W&I response to TAS information request (Aug. 28, 2012).

29 *See* W&I response to TAS information request (Nov. 19, 2012).

30 On October 17, 2012, TAS requested information from the IRS showing the number of returns over a period of years that AMTAP selected for screening, the volume selected for manual verification, and the volume ultimately cleared for refund. AMTAP instead provided TAS with the volume of information documents (IDOCs) selected for verification. As TAS cannot directly correlate the number of IDOCs to the number of returns, we are unable to show the relationship of selected/verified/released returns. *See* W&I response to TAS information request (Nov. 19, 2012).

The IRS Should Use Hard Refund Freezes Only When There Is an Indication of Fraud, Not as an Inventory Management Tool.

Given the importance of protecting taxpayers and the tax system from refund fraud and improper payments, the National Taxpayer Advocate believes the IRS should have a reasonable time to determine whether a refund claim bears the "badges of fraud" or is otherwise suspect, such that it should be held for further investigation or examination. As provided in the 2006 memorandum, the IRS and the National Taxpayer Advocate agreed that, unless IRS referred the claim for criminal investigation, releasing refunds systemically within 70 calendar days of the initial claim struck an appropriate balance between revenue protection and taxpayer burden.[31] As a consequence, CI issued guidance stating that claims "must be resolved within 70 calendar days; if not, the refund will be automatically released through master file programming."[32]

However, when the QRP transferred from CI to W&I, the IRS reneged on its commitment to release refunds if it cannot determine in a reasonable time that a claim requires additional investigation. Current procedures advise IRS employees that "[i]t may be necessary to take additional actions to hold the refund after the 11 cycle freeze [77 days] if a permanent freeze has not posted and the final return disposition still is uncertain."[33] In practice, the IRS *routinely* extends refund freezes by placing hard freezes on accounts, as evidenced by the subsequent freeze applied to 142,000 taxpayer accounts in FY 2012 — almost 10 percent of all taxpayer accounts selected for verification by AMTAP.[34] Instead of releasing refunds after 11 weeks when it cannot determine they warrant deeper scrutiny, AMTAP is placing hard freezes on the accounts in which fraudulent activity is suspected, because it could not verify wages and withholding within the established timeframe. In other words, AMTAP is using a hard freeze as an inventory management tool, without sufficient analysis of relative risk.

Concerned about the increasing delay in AMTAP's review of these cases, the National Taxpayer Advocate asked that AMTAP extend the "soft" freeze, rather than applying a hard freeze on these 142,000 accounts. EFDS systems limitations prevent AMTAP from extending the soft freeze of 11 weeks originally placed on the accounts, and a "hard" freeze must be applied to prevent the systemic release of these refunds.[35] The inherent problem with a hard freeze is that once it is placed on an account, the IRS faces no external pressure to

31 *See* Memorandum Regarding IRS Criminal Investigation Questionable Refund Program Procedures (Feb. 3, 2006); National Taxpayer Advocate 2006 Annual Report to Congress 412; IRS, *Fraud Detection Center - FDC Guidelines for Processing Year 2007 Issued by Refund Crimes and the Fraud Detection Centers* 17 (Dec. 2006). When AMTAP inputs a TC 971 AC 134, the module is systemically frozen from refunding for 11 weeks. If AMTAP has missed the cutoff to input the TC 971 AC 134, it must input a "hard" freeze, which has no systemic release.

32 *See* IRS, *Fraud Detection Center - FDC Guidelines for Processing Year 2007 Issued by Refund Crimes and the Fraud Detection Centers* 17 (Dec. 2006). At that time, returns underwent a one-week "re-sequencing" period (now two weeks) while processing, so the refund hold was for 77 days.

33 IRM 21.9.1.2.3 *Stopping the Refund* (Mar. 1, 2012). Generally, returns selected for verification before the refund stop date will follow an automatic EFDS process to stop the refund for 11 weeks (with input of the TC 971-134). Returns that require manual verification or have unsubstantiated withholding, etc., will require a manual hold or "hard" freeze, which holds the refund permanently (until another action is taken to release the refund).

34 Email from AMTAP (May 10, 2012).

35 *Id.*

work the case quickly. These returns can be left to languish while IRS works subsequent returns, re-creating the 2005 debacle all over again.[36]

As Yearly Screening Volumes Increase, Imperfect Screens Trap and Harm Taxpayers.

As the total volume of tax returns selected for screening has increased over the past several years, so has the volume of information documents selected for manual verification of wages. The number of information documents (IDOC's) that IRS selects for verification has risen 238 percent from 2010 to 2012. See Figure 1.6.1 below.[37]

FIGURE 1.6.1, Increase in AMTAP Verification of Information Documents (IDOCs)

	2009	2010	2011	2012 thru 10/15
Selected for Verification	361,313	432,752	882,516	1,460,526
Verification Completed	285,417	386,756	769,607	1,452,549
Verified Bad	193,333	328,756	684,907	1,345,532
% Bad	68%	85%	89%	93%

Note: These are IDOC volumes, not tax return volumes.[38]

Correspondingly, the number of taxpayers caught up in the EFDS filters that AMTAP ultimately determined were entitled to the refunds they claimed also rose. AMTAP's reports show that the number of legitimate refund claims that the system potentially impacted has risen from 58,013 in 2010 to 84,656 in 2011 and to 101,678 in 2012.[39] This represents a 75 percent increase in the last three years.

As the IRS stops refunds, TAS receives more requests for help from the taxpayers. Between FY 2010 and FY 2012, TAS pre-refund cases rose 468 percent and constituted 8.2 percent of TAS case receipts in FY 2012.[40]

36 *See* National Taxpayer Advocate 2005 Annual Report to Congress 25.

37 *See* W&I responses to TAS information requests (Aug. 28, 2012, and Nov. 19, 2012).

38 On October 17, 2012, TAS requested information from the IRS showing the number of returns over a period of years that AMTAP selected for screening, the volume selected for manual verification, and the volume ultimately cleared for refund. AMTAP instead provided TAS with the volume of IDOCs selected for verification. AMTAP stated that data mining modeling is applied against "returns" and "returns" are selected for screening. Verification is performed on "Information Documents" associated to those returns that were determined to need verification. *See* W&I response to TAS information request (Aug. 28, 2012); *see* email from AMTAP (Oct. 29, 2011).

39 *See* W&I response to TAS information request (Nov. 19, 2012). AMTAP reports that 93 percent of information return documents in FY 2012 could not be verified as accurate (the IRS refers to these as "verified bad"). The remaining seven percent may include information return documents that are inconclusive or take longer to verify as inaccurate. However the National Taxpayer Advocate has repeatedly questioned what the IRS means by "verified bad." A significant percentage of taxpayers who come to TAS for assistance with AMTAP-related cases subsequently receive full refunds, as the information reported on their returns is ultimately verified as accurate. *See* TAS 2011 Study and TAS 2012 Study.

40 TAMIS/Business Objects (BOBJ) Report FY Receipts 2010, 2011, and 2012.

FIGURE 1.6.2, TAS Pre-Refund Wage Verification Case Receipts, FY 2010–FY 2012

	FY 2010	FY 2011	FY 2012
AMTAP QRP Receipts	3,171	21,286	18,012
TAS Total Case Receipts	289,933	295,904	219,666
AMTAP QRP Receipts as a Percentage of TAS Receipts	1.1%	7.2%	8.2%

TAS conducted studies in 2011 and 2012 to determine, among other things, the reason these taxpayers seek our assistance. And as previously mentioned, the studies revealed the number of taxpayers seeking TAS help because of financial difficulties attributable to IRS action or inaction rose from 50 percent in 2011 to 86 percent in 2012.[41] On average, it took six months in 2011 and three months in 2012 for these taxpayers to receive their refunds.[42] (The 2011 study population included returns from tax years 2009 and 2010, while the 2012 study population included returns from tax year 2011 alone. Thus, the 2012 study reflected a shorter cycle time because it did not include prior year returns.)

Returns claiming the EITC made up nearly 17 percent of all cases the IRS selected for verification in calendar year (CY) 2012.[43] When the IRS holds legitimate refunds for extended periods, it further exacerbates the taxpayers' hardships, especially for low income taxpayers who may need the refunds for food, medical care, rent, or utilities. Previous studies of AMTAP cases revealed that the frozen refunds on cases claiming EITC and showing low income strata represented over 25 percent of the taxpayers' yearly incomes.[44]

In TAS's 2012 review of pre-refund cases, 53 percent of the taxpayers claimed and received EITC. These taxpayers waited more than three months for a median refund of $5,175. The refunds comprised 38 percent of their adjusted gross income.[45]

The IRS Does Not Always Send Notices or Verify Returns When It Identifies Questionable Refund Claims, Contrary to its 2006 Agreement with the National Taxpayer Advocate.

The IRS encounters many different types of schemes designed to defraud the government and its taxpayers. One significant scheme, identified by the IRS in 1999, has been dubbed "Operation Mass Mail" (OMM). Originally, the perpetrators used Social Security numbers (SSNs) from Puerto Rican residents due to the unlikely probability that those individuals

41 *See* TAS 2011 Study; TAS 2012 Study. The 2011 TAS study included 2009 and 2010 tax returns closed in 2011.

42 *See id*. The 2012 study included only 2011 tax returns closed in 2012. As the 2012 study did not include prior year returns, the refund hold time was considerably shorter than in the 2011 study. In the 2012 study, 71 percent of taxpayers received full relief and waited on average more than three months to receive that refund.

43 *See* W&I response to TAS information request (Nov. 19, 2012).

44 National Taxpayer Advocate 2005 Annual Report to Congress vol. 2, 2, 12 (*Criminal Investigation Refund Freeze Study*). Over half of the taxpayers in this study had an adjusted gross income of less than $13,000. On average, the frozen refunds represented 25 percent of the taxpayers' yearly income. Nearly 75 percent of the taxpayers who claimed the EITC were allowed the credit after IRS processing. The average amount of the EITC initially claimed was $2,853. Overall, 80 percent of the taxpayers in the study received at least a partial refund, after waiting on average nine months.

45 TAS 2012 study. There were 241 EITC taxpayers in our random sample of 494 PIC 045 cases. The median AGI was $14,101, median refund was $5,175, and median refund hold was 99 days.

will file a U.S. tax return. In recent years, perpetrators have been using SSNs from U.S. territories as well as the 50 states. As a way to combat this scheme, the IRS looks for tax returns containing certain characteristics. If a return fits this profile, it is not processed (in IRS parlance, it is "auto-voided").[46] When a return is auto-voided, the IRS does not process the return; rather, the IRS archives the return. If the taxpayer later comes forward and confirms his/her identity as a legitimate taxpayer with a filing obligation, the IRS will retrieve the return and process it as of the original filing date.

The IRS stops hundreds of thousands of OMM returns each year, and believes the OMM matrix it developed to combat the scheme is highly effective. In CY 2012, AMTAP identified approximately 934,504 returns that fit OMM criteria.[47]

The National Taxpayer Advocate commends the IRS for taking proactive measures to protect the public fisc from fraudulent refund claims. However, we are concerned that the criteria used to identify an OMM return are sweeping in their reach and could ensnare legitimate taxpayers.[48]

As the IRS does not send notices to OMM-affected taxpayers or verify the information on returns that it suspects may belong to the OMM scheme, taxpayers only learn their returns were auto-voided when they call to inquire about their refunds. At that point, the IRS Customer Service Representative (CSR) will instruct the taxpayer to re-submit the return, but will not tell him or her about its auto-void status.[49] When the taxpayer resubmits the return (*e.g.*, TAS secures and forwards the taxpayer's return), AMTAP will screen and verify it. If the return verifies as good, AMTAP will code it with a Special Processing Code (SPC) "B" and forward it to be processed. However, the resubmitted return will not post and must be manually "forced" to post.[50]

The IRS has an obligation to expedite the processing of a resubmitted return when it is known to be legitimate. These taxpayers have already been harmed by the IRS's failure to notify them that their returns have been deemed invalid and auto-voided. The IRS should institute programming that will allow the taxpayers' subsequent valid returns, once verified, to post immediately. Instead, returns identified as OMM will not automatically be processed, even after they are reviewed and coded as "good." The IRS has indicated that it planned to revise its programming to allow the returns with SPC B to be processed

46 IRM 3.12.2.279.7 (Jan. 1, 2012). Auto-voided or auto-rejected cases are closed automatically without human intervention. These processes apply to all unpostable areas/functions. *See* IRM 3.12.179.4.6 (Jan. 1, 1998).

47 AMTAP identified 934,504 OMM returns through October 15, 2012. *See* W&I response to TAS information request (Nov. 19, 2012).

48 The National Taxpayer Advocate is not at liberty to disclose these OMM criteria, but has expressed her concern to the highest levels of the IRS about the sweep of these rules and their underlying assumptions.

49 *See* IRM 21.5.6.4.35.3 (May 9, 2012).

50 IRM 10.5.3.2.2.4.4 (Nov. 15, 2011). Some of the taxpayers whose returns were marked "OMM" came to TAS for help in obtaining their refunds. In the 2011 TAS study, 23 out of 373 cases (six percent) were identified as OMM cases. Of these, TAS was able to obtain relief in 17 cases, or 74 percent of the time (with full relief in 16 cases, 70 percent of the time). For further details, see National Taxpayer Advocate 2011 Annual Report to Congress 36-37.

without further delay.[51] However, the IRS has not committed resources to change the programming.

To summarize, after waiting months for a refund, not knowing that the IRS voided the return, calling, and re-submitting the return, the taxpayer must still wait. The resubmitted return will automatically go unpostable, even after verification shows it is correct, because the IRS has not made it a priority to allow these returns to post. Thus, the IRS's inaction continues to harm these taxpayer-victims of IRS processes, and creates re-work for its own employees.

Lack of Transparency in the AMTAP Operation Leaves Both IRS Employees and Taxpayers in the Dark, and Generates Downstream Work.

The Electronic Fraud Detection System allows AMTAP to screen and verify returns suspected of fraud, but it is much more. EFDS is AMTAP's inventory management program and records actions taken on returns. There is one big disadvantage to this approach, though — for the most part, only AMTAP employees have access to EFDS.

Under the 2006 agreement with the National Taxpayer Advocate, EFDS now automatically generates a notice to a taxpayer when his or her return is selected for screening. The letter advises the taxpayer that the refund is being held for additional review, lists four items that may be reviewed (income, withholding, credits, and business income), and includes a toll-free number that the taxpayer can call if he or she does not receive the refund or hear from the IRS within 45 days.[52] The number will connect the taxpayer with an AM customer service representative.[53]

Almost 25 percent of those receiving these notices called the IRS in 2012.[54] As of October 8, 2012, the IRS had issued over one million such notices and the CSRs in AM had received almost 265,000 calls about them.[55] When a taxpayer calls, the CSR cannot advise the taxpayer about the status of the review, as only AMTAP has access to that information. Instead, the taxpayer, who has already waited 45 to 60 days, must wait again while the CSR completes and sends Form 4442 (which CSRs use to record a taxpayer's request in regard to a tax return) to AMTAP to inform it that the taxpayer has called.[56] If after another 45 days have passed, the taxpayer still does not receive a response from AMTAP, and the case

51 IRM 10.3.2.2.4.4 (July 8, 2010). Special Processing Code "B will bypass the UPC 147.

52 *See* IRS CP05 notice.

53 *Id*.

54 *See* W&I response to TAS information request (Nov. 19, 2012).

55 The volume of CP05 notices was as of October 8, 2012. The call volumes are estimates. *See* W&I response to TAS information request (Nov. 19, 2012). Note: Some calls received on these issues may be from perpetrators posing as legitimate taxpayers in a further attempt to receive a fraudulent refund.

56 IRM 21.5.6.4.35.3 (Oct. 3, 2012).

involves identity theft, the CSR will send a second Form 4442 to the AM Identity Protection Specialized Unit (IPSU).[57] Cases that do not involve identity theft are referred to TAS.[58]

Delays in the AMTAP process generate additional calls and paperwork, and consume the resources of multiple IRS units.[59] The IRS should revamp and streamline its process to more efficiently assist taxpayers whose returns have been selected for review by EFDS. Phone calls in response to notices should be directed to AMTAP in real time, as only AMTAP employees can apprise the taxpayer of the status of his or her account. Not only is it a waste of IRS resources for the taxpayer to speak to IRS employees from various functions, but the taxpayers are more likely to be confused about what documentation the IRS needs, or may have to submit documentation multiple times, or they may just give up — not because they aren't entitled to the refund, but because they just don't have the wherewithal to handle the runaround.

Coordination Between Business Functions Is Imperative to the Efficient and Smooth Transfer of Case Work.

Few things are more frustrating for taxpayers than calling the IRS about their refunds and being told that the IRS cannot locate their cases. It is understandable that different functions within the IRS will need to work on a case, but the IRS must ensure that the transfer is seamless, and cases do not get lost.

In 2011 and 2012, TAS worked with AMTAP and Examination ("Exam") trying to locate taxpayer returns targeted for transfer to Exam from AMTAP. AMTAP could not tell TAS what campus Exam office received the work, because the case had not opened up on Exam's Audit Information Management System. It was ascertained that Exam's case codes did not match the issues on the returns that needed to be examined, and conversely the returns could not be systemically transferred to Exam. Some were rejected back to AMTAP, where they languished without being reviewed; others just remained in limbo. TAS case advocates endured months of not being able to respond substantively to taxpayers' inquiries, increasing taxpayer and TAS burden. This problem continues, revealing both a lack of recordation and coordination to ensure the successful transfer of returns from one function to another.

57 In general, cases will be forwarded to IPSU if the taxpayer is a victim of identity theft and the case meets TAS criteria 5-7 (systemic burden). *See Memorandum of Understanding Between the National Taxpayer Advocate and the Commissioner, Wage & Investment to Transition TAS Criteria 5-7 Identity Theft Cases to Wage & Investment Identity Protection Specialized Unit (IPSU)* (Mar. 31, 2010).

58 IRM 21.5.6.4.35.3 (Oct. 3, 2012).

59 *See* Most Serious Problem: *The IRS Telephone and Correspondence Services Have Deteriorated Over the Last Decade and Must Improve to Meet Taxpayer Needs*, *infra*.

CONCLUSION

The IRS must deal with the challenging combination of increasing opportunities for refund fraud and decreasing resources to combat such activities. However, in using new screens and programs, the IRS must be careful not to repeat the mistakes identified in the QRP program in 2005. When the IRS deletes returns without notifying taxpayers or imposes extended delays on refunds, taxpayers will call. Exacerbating the situation, the taxpayer often cannot get through, or must wait extended periods to speak to a phone assistor, only to find that the assistor cannot tell the taxpayer anything about the status of the account. This situation creates both downstream work and taxpayer burden. Taxpayers need timely notice of refund holds, the ability to talk to a phone assistor when calling, accurate accounting of their return status, clear notification that explains consequences, and prompt and accurate resolution of legitimate claims. The fact that over 100,000 taxpayers, many of whom are low income and waiting for refunds that make up more than a third of their AGI, are ensnared in these processes, should drive the IRS to resolve these problems immediately, with a sense of urgency.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. Provide the AMTAP unit sufficient staff and systems resources to work its inventory timely.
2. Adhere to the policy of systemically releasing refunds after 70 days if the IRS cannot determine that the return is part of a known scheme or requires greater scrutiny; and if additional time is needed, program systems so the soft freeze can be extended for 30 day intervals.
3. When taxpayers call inquiring about refunds, direct them to the personnel with access to the most current information regarding their account.
4. Notify taxpayers with legitimate refund claims that become ensnared in the OMM scheme that their returns have been voided, and institute programming that will allow their re-submitted returns to be processed without further delays.
5. Track the number of tax returns "verified bad" by the Electronic Fraud Detection System, in addition to the number of information documents.
6. Develop a system for recordation of case transfers to Exam and scheduled reviews to address rejected referrals.

IRS COMMENTS

The Taxpayer Assurance Program, known as AMTAP, recently completed its third filing season, and its first as part of the new Return Integrity and Correspondence Services (RICS) organization. RICS was established in October 2011 to create a centralized organization for ensuring revenue protection and refund compliance. The new RICS office has quickly moved to balance the taxpayer experience, revenue protection and resource efficiency. For filing season 2012, RICS increased AMTAP staffing significantly and trained all AMTAP

permanent employees on account work to dedicate more highly skilled employees to successfully tackle the complex challenges of refund fraud and identity theft work. To further protect taxpayers and their refunds, the RICS organization deployed a specialized identity theft unit in FY 2012.

The IRS recognizes the need to always protect taxpayer rights. We must continually balance the rights of taxpayers with our responsibility to protect the interests of the United States and the majority of taxpayers who accurately file and pay their federal taxes. The voluntary compliance design of America's tax system requires the IRS to take efforts to support compliant taxpayers by detecting fraud and errors of those looking to be noncompliant. It is a continuous challenge to quickly identify perpetrators and individuals who use sophisticated methods to defraud the nation's tax system. This detection can be more time-consuming when individuals are not associated with a known scheme, and cases require analysis, third-party information, and actions to assure that legitimate taxpayers are protected.

As those attempting to commit refund fraud become more sophisticated, the IRS must take steps to respond accordingly. As discussed above, the IRS continues to recognize the importance of taxpayer rights, but we must ensure that processes are in place to effectively stop refund fraud. We consistently work to improve our fraud detection methods by developing improved system models to combat new fraud trends.

Those looking to defraud the government have become more brazen and are availing themselves to a variety of resources both outside and within the system to try to force the release of false refunds. In some cases, this even includes calling Taxpayer Assistance toll-free telephone numbers or seeking support through the Taxpayer Advocate Service. One example involves over 200 filings that IRS deemed fraudulent with associated revenue protected of more than $800,000. Thirty of those false returns had an open TAS case; meaning that perpetrators have contacted the IRS through TAS to try to force the release of the associated refunds. As another example, Operation Mass Mail is a scheme where perpetrators contact toll-free assistors and TAS to force refund release. In dealing with these situations, the IRS follows established taxpayer support requirements, which require use of valuable resources to ensure that the fraud determination is correct. These two examples are just a snapshot of the challenges to the IRS in maintaining a balance between protecting federal revenue and providing valid taxpayer support while minimizing taxpayer burden.

The IRS has increased its AMTAP staffing for the upcoming filing season and will assess the efficiencies gained from accelerated availability of Information Returns data to determine appropriate resource utilization and allocation for handling inventory. We will explore options to direct taxpayers to the personnel who can provide them with the most recent account status information.

With respect to the recommendation that the IRS track the number of tax returns "verified bad" by EFDS in addition to information documents, note that returns are verified as "bad" through the verification process, not by EFDS. Returns are selected for screening

while verification occurs based upon the information documents associated with the return. AMTAP does track the number of bad/stopped returns in addition to information documents.

With respect to case transfers, a system exists for tracking referrals to Exam. Any return referred to Exam in a particular processing year can be tracked via EFDS. Reviews of rejected returns currently occur on a regular basis. RICS performed an in-depth analysis surrounding the specific reject reasons in 2012. For 2013, a work request has been submitted for system updates to help facilitate with the processing of rejected returns.

While the IRS strives to release all valid returns as soon as possible, we cannot commit to an automatic release in cases in which issues are suspected. The IRS developed revenue protection processes over many years using historical data to determine that fraud is indicated. The IRS refines fraud models each year based on performance and new characteristics and updates procedures for reviewing and processing revenue protection inventory accordingly to ensure that there are indications of fraud before holding a refund. Manual screening processes also ensure that a return meets established fraud characteristics before designation for verification and refund hold. Due to the historical evidence of known fraud, the explosion in fraud and identity theft in the past two years, and the consistent amount of revenue protected by IRS fraud detection efforts developed from this analysis, the IRS must maintain the right to determine when a hard refund freeze is appropriate. The IRS is exploring options to extend the soft freeze in increments. Note that the IRS corresponds with taxpayers when returns are sent through the fraud verification process.

With respect to the OMM scheme, IRS developed the policy to "auto-archive" returns based on historical analysis of repeated fraud characteristics. For example, the Operation Mass Mail scheme is a very high volume scheme attempted annually. Part of the scheming effort is to inundate IRS with returns to force release of some of the refunds. In calendar year 2012, we received 363,837 OMM returns through EFDS and only 0.7 percent of these were valid. Because of the low incidence that valid returns are impacted, attempting to correspond on these fraudulent returns would be an ineffective use of resources and taxpayer dollars. These returns often have an address not associated to the Social Security number owner or may use a decedent SSN or be a first-time filing where there is no good address. Experience with corresponding on other types of revenue protection inventory shows us that it is highly likely that correspondence would come back as undeliverable, resulting in a waste of the resources used to create and mail the correspondence, as well as the creation of unnecessary back-end. Expending our limited resources on this work is not prudent. In addition, corresponding provides those committing fraud with additional or new avenues to try to force refund release by giving them toll-free numbers to contact. By auto-archiving the massive volumes of these fraud returns and only processing a return when a true SSN owner is known and submits a valid filing, the IRS saves taxpayer dollars and reduces negative impact that would result from trying to treat them as legitimate filings when they meet well-established, known fraud markers. We have found that where a real taxpayer exists, they will contact the IRS. At that point we will work with the taxpayer to issue the refund.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate fully recognizes the need for the IRS to thoroughly screen refund claims before processing payments to taxpayers. We do not disagree that perpetrators have become more crafty, bold, and persistent in their attempts to obtain refunds to which they are not entitled. We encourage the IRS to continue improving its fraud detection filters to combat refund fraud more effectively.

Yet even in this environment, the National Taxpayer Advocate is compelled to remind the IRS that all taxpayers are entitled to due process. Assuming that the IRS is accurate when it estimates 93 percent of the 1.4 million returns stopped by EFDS contain inflated refund claims, that could leave more than 100,000 taxpayers whose legitimate claims will be held up unnecessarily. Although the IRS may view EFDS scoring or OMM matrices as reliable indicators of fraud, it is important that the taxpayer be given an opportunity to present facts to support his or her claim. Even the most reliable filters will ensnare legitimate filers. The IRS must be prepared to assist these honest taxpayers as quickly as possible.

In 2006, the National Taxpayer Advocate met with IRS leadership to discuss what would be an acceptable amount of time for a taxpayer whose return has been frozen to wait for the IRS to complete its verification. All parties agreed that 70 days should be sufficient, and if the verification could not be finished within that period, the IRS would release the refund freeze unless it had reason to believe further investigation was necessary. Today, the IRS is saying that 70 days is not long enough, and is routinely applying hard freezes on taxpayer accounts, in violation of the 2006 memorandum of understanding.

The National Taxpayer Advocate has never questioned the IRS's right to impose a "hard freeze" where the facts of the case warrant one. However, in its response, the IRS is maintaining that it should have the ability to impose a "hard freeze" even where the facts *do not* warrant. The IRS bases this position on what it calls "historical evidence of known fraud." Yet in justifying its position, the IRS ignores the most compelling "historical evidence" cited in our report — namely, that the number of legitimate tax returns ensnared in IRS anti-fraud filters has increased by 75 percent over the last three years, from 58,013 in 2010 to 101,678 in 2012. If the IRS cared about providing relief to these legitimate taxpayers as much as it cared about stopping fraud, TAS would have far fewer refund fraud cases in its inventory.

If AMTAP is truly inundated by so many questionable refund claims that the unit cannot keep up with its verification inventory, then the IRS should bring all parties together and propose an adjustment to the 70-day timeframe. At a minimum, the IRS should institute programming that would allow AMTAP to extend the temporary freeze by 30 days on a case-by-case basis. Instead, AMTAP unilaterally decided to permanently freeze accounts — more or less as an inventory management tool. The National Taxpayer Advocate

is concerned that when AMTAP applies a permanent freeze, the unit will feel no external pressure to complete the verification in a timely manner, and taxpayers will be harmed by waiting significantly longer than the 70 days agreed upon in 2006.

In this Most Serious Problem discussion, the National Taxpayer Advocate has proposed several extremely reasonable recommendations that will bring relief to legitimate taxpayers who are caught up in the IRS' necessary fraud protection actions while still allowing the IRS to vigorously protect revenue. The IRS's dismissal of these recommendations in its response demonstrates its lack of commitment to taxpayers who are the victims of its processes. The National Taxpayer Advocate wonders how many more taxpayers must be harmed in this way before the IRS decides it is "worth" acting.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Provide the AMTAP unit sufficient staff and systems resources to work its inventory timely.
2. Adhere to the policy of systemically releasing refunds after 70 days if the IRS cannot determine that the return is part of a known scheme or requires greater scrutiny.
3. If the IRS requires additional time to research a questionable refund claim, enable AMTAP to extend soft freezes in 30-day intervals.
4. Institute programming that will allow immediate processing of tax returns re-submitted by legitimate taxpayers caught by the OMM filters.
5. When taxpayers call inquiring about refunds, direct them to the personnel with access to the most current information regarding their account.
6. Track the number of tax returns "verified bad" by AMTAP, in addition to the number of information documents.
7. Develop a system (apart from EFDS) for tracking case referrals to Exam, as not all employees have access to EFDS.

MSP #7

The IRS's Compliance Strategy for the Expanded Adoption Credit Has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS, and Does Not Bode Well for Future Credit Administration

RESPONSIBLE OFFICIAL

Peggy Bogadi, Commissioner, Wage and Investment Division

DEFINTION OF PROBLEM

The adoption tax credit was created in 1996 to encourage adoption and help offset the potentially onerous costs associated with the process, particularly for low and middle income families.[1] The Patient Protection and Affordable Care Act increased the maximum credit amount under Internal Revenue Code (IRC) § 36C and made the credit fully refundable for 2010 and 2011.[2] The changes to the credit caused the IRS to alter its compliance strategy to focus on minimizing improper payments and stopping potentially fraudulent claims. As a result:

- During the 2012 filing season, 90 percent of returns claiming the refundable adoption credit were subject to additional review to determine if an examination was necessary.[3] The most common reasons were income and a lack of documentation.
- Sixty-nine percent of all adoption credit claims during the 2012 filing season were selected for audit.[4]
- Of the completed adoption tax credit audits, over 55 percent ended with no change in the tax owed or refund due in fiscal year 2012.[5] The median refund amount involved in these audits is over $15,000 and the median adjusted gross income (AGI) of the taxpayers involved is about 64,000.[6] The average adoption credit correspondence audit currently takes 126 days, causing a lengthy delay for taxpayers waiting for refunds.[7]

1 Over 30 percent of all adopted children and over 45 percent of the children adopted from foster care live in households with incomes no higher than twice the poverty threshold. U.S. Dep't of Health and Human Services, *Adoption USA: A Chartbook Based on the 2007 National Survey of Adoptive Parents*, 60 (2009). "The high cost of adoption can be an impediment to many families wanting to adopt. With the inclusion of legal fees, court costs and charges levied by adoption agencies, the cost of an adoption can exceed $15,000. This is a heavy burden for America's low- and middle-income families who desire to adopt. The $5,000 adoption tax credit included in this may make the difference between a child in foster care becoming part of an adoptive family or remaining in foster care indefinitely." Louis Stokes, Extension of Remarks (Delivered May 10, 1996), Congressional Record, Volume 142, Issue 67 (May 14, 1996), E787- Adoption Promotion and Stability Act of 1996 - 104th Congress, 2nd Session.

2 Pub. L. No. 111-148, § 10909, 124 Stat. 119 (2010) (codified in IRC §36 C).

3 IRS Production Report, Adoption Credit Compliance Filters Report Through Cycle 2012-38 (Through Sept. 14, 2012).

4 *Id.* Includes late filed 2010 returns as well as 2011 returns. IRS 7-day response (Nov. 29, 2012).

5 IRS Compliance Data Warehouse Automated Information Management System (AIMS) FY 2010, 2011 and 2012 (Nov. 2012).

6 Individual Master File (IMF), Transaction History File, Transaction Code 766 with a Credit Reference Number 261 for tax year 2010 returns processed in calendar year 2011 and tax year 2011 returns processed in calendar year 2012 and Individual Returns Transaction File tax year 2010 and 2011 from Compliance Data Warehouse (Nov. 2012).

7 IRS, Compliance Data Warehouse Automated Information Management System (AIMS), Project codes 355 and 423 for FY 2012 (Nov. 2012).

- Seventy-nine percent of returns selected for audit in filing season 2012 had missing, invalid, or insufficient documentation.[8]
- Despite Congress' express intent to target the credit to low and middle income families, the IRS created income-based rules that were responsible for over one-third of all additional reviews in FY 2012.[9]
- Of the $668.1 million in adoption credit claims in tax year (TY) 2011 as a result of adoption credit audits, the IRS only disallowed $11 million — or one and one-half percent — in adoption credit claims.[10] However, the IRS has also had to pay out $2.1 million in interest in TY 2011 to taxpayers whose refunds were held past the 45-day period allowed by law.[11]

TAS and the Government Accountability Office (GAO) have previously identified several specific concerns regarding the IRS's administration of the adoption credit.[12]

- The IRS did not inform taxpayers how long it would take to audit their returns and when they could expect a refund;
- The hold on the adoption credit portion of the refund caused financial burden for some eligible taxpayers;
- Auditors asked taxpayers to provide documentation before reviewing the information the taxpayers included with their original returns, so taxpayers who already submitted documentation had to send it twice;
- The inability of taxpayers to e-file returns claiming the credit resulted in delays and additional burden on taxpayers and the IRS;
- A lack of outreach has left many taxpayers unaware of their responsibilities in claiming the credit; and
- Examiners were not knowledgeable about the expanded adoption credit and how to handle the credit claimed for special needs children, thereby undermining the public policy the credit was designed to address.

8 Wage and Investment Division (W&I) response to TAS research request (Nov. 28, 2012). Numbers shown are for tax year 2011 returns filed in 2012 (through October 12, 2012), down slightly from 80 percent with missing, invalid, or insufficient documentation in TY 2010.

9 IRS Production Report, Adoption Credit Compliance Filters Report through Cycle 2012-38 (through Sept. 14, 2012). Includes late-filed 2010 returns as well as 2011 returns. A single claim can trip more than one filter.

10 W&I response to TAS research request (Nov. 16, 2012). Of the $1.1 billion in adoption credit claims in tax year 2010 as a result of adoption credit audits, the IRS disallowed $115 million – or ten percent – in adoption credit claims. IMF, Transaction History File, Transaction Code 766 with a Credit Reference Number 261 for tax year 2010 returns processed in calendar year 2011 and tax year 2011 returns processed in calendar year 2012 from Compliance Data Warehouse (Nov. 2012).

11 IMF, Transaction History File, Transaction Codes 770, 771, 772, 776, and 777 for FY 2011 and 2012 Adoption Credit Audits in Project Codes 355 and 423 on AIMS from Compliance Data Warehouse (Nov. 2012). IRC § 6611. For a timely filed return, the IRS must pay any overpayment within 45 days from the due date of the return, or pay interest as established in IRC § 6621.

12 National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 35-36; National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 46-47. GAO, GAO-12-98, *Adoption Tax Credit* (Oct. 2011).

Administering the refundable adoption tax credit has clearly posed a challenge to the IRS, in part because it failed to consider certain administrative issues related to refundable credits, as recommended by the National Taxpayer Advocate.[13] The large dollars at stake — up to $13,360 in 2011[14] — and potential for fraud have led to excessive delays and an inefficient use of IRS resources. The IRS's failure to engage in proactive outreach continued the cycle of problems that plagued taxpayers and the IRS. While the refundable portion of the adoption credit may have expired, the IRS must still move forward to improve its administration of the credit and learn from its mistakes.

As the National Taxpayer Advocate has noted in prior discussions of administering social policies through the Internal Revenue Code, the IRS must tailor its procedural requirements to the characteristics and capabilities of the target taxpayer population.[15] With respect to the Adoption Credit, and in particular the credit for adoption of special needs children, the IRS has failed abysmally to take into account that over 45 percent of adopting families are at or below 200 percent federal poverty level, presenting particular communication and functional literacy challenges even as they are desperately in need of the funds which Congress has sought to deliver to them.[16]

The IRS's misguided procedures, and its failure to adequately adjust these processes when it learned its approach was seriously flawed, have caused significant economic harm to thousands of families who are selflessly trying to improve the lives of vulnerable children.[17] Unless the IRS changes its approach to refundable credits and adopts more taxpayer-focused procedures, it will continue to cause problems for eligible taxpayers, including those eligible for the new refundable credit contained in the Patient Protection and Affordable Care Act — the Premium Tax Credit.[18]

13 National Taxpayer Advocate 2009 Annual Report to Congress 75 (Study: *Running Social Programs Through the Tax System*).

14 IRS, Tax Topics, *Topic 607: Adoption Credit and Adoption Assistance Programs for 2010 and 2011 available at* http://www.irs.gov/taxtopics/tc607.html (last visited Nov. 15, 2012).

15 National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS's Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*); National Taxpayer Advocate 2009 Annual Report to Congress 75 (Study: *Running Social Programs Through the Tax System*).

16 U.S. Dep't of Health and Human Services, *Adoption USA: A Chartbook Based on the 2007 National Survey of Adoptive Parents*, 60 (2009).

17 In FY 2012, over 55 percent of adoption credit audits – over 35,000 audits – ended with no change in the tax owed or refund due. However, those taxpayers were forced to wait until the end of the audit to receive the adoption tax credit portion of their tax refund. IRS Compliance Data Warehouse Automated Information Management System (AIMS) FY 2010, 2011 and 2012 (Nov. 2012).

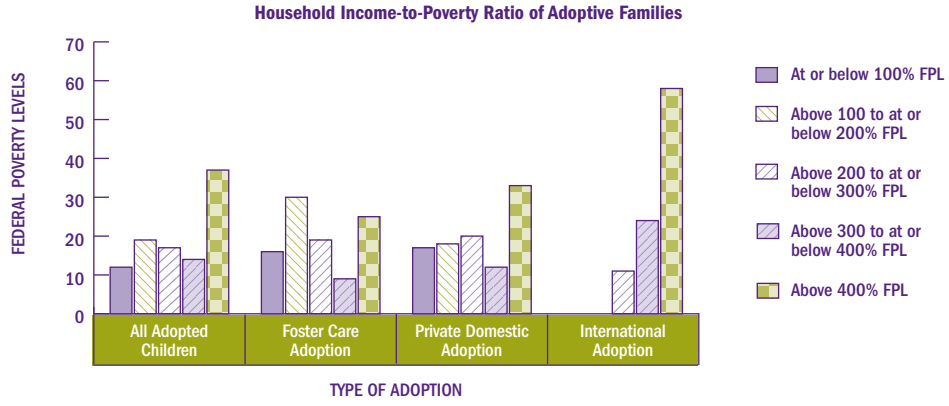
18 Beginning in 2014, the Affordable Care Act creates a refundable tax credit for coverage under a qualified health plan. The credit is available to eligible individuals and families with incomes below a specified threshold (subject to an income phase-out range) and subsidizes the purchase of health insurance through an exchange. IRC § 36B.

ANALYSIS OF PROBLEM

Background

As of September 30, 2010, over 400,000 children were in foster care. Over 100,000 of them, who are awaiting adoption,[19] have been in continuous foster care for an average of more than three years.[20] The out-of-pocket costs associated with adoption vary. Domestic adoptions through a public adoption agency can cost from zero to $2,500. However, private and international adoptions can range from $5,000 to more than $40,000.[21] As seen in Figure 1.7.1, over 30 percent of all adopted children and over 45 percent of the children adopted from foster care live in households with incomes no higher than twice the poverty threshold.[22]

FIGURE 1.7.1, Household Income-to-Poverty Ratio of Adoptive Families[23]



19 U.S. Dep't of Health and Human Services, *The AFCARS Report: Preliminary FY 2010 Estimates as of June 2011*, 1, 5 (June 2011).

20 *Id*. at 5 (June 2011).

21 Child Welfare Information Gateway, *Funding Adoption: Adoption Packet 2*, 2 (Feb. 2011).

22 U.S. Dep't of Health and Human Services, *Adoption USA: A Chartbook Based on the 2007 National Survey of Adoptive Parents*, 60 (2009).

23 *Id*. Entries marked with a * indicate that the relative standard error exceeds 0.30. Percentages may not add up to 100 due to rounding.

The Adoption Credit Was Established, in Part, to Help Offset the Cost for Low and Middle Income Families

The Adoption Tax Credit was established in 1996 to promote adoption and help offset its costs, particularly among low- and middle-income families. As noted during congressional discussion of the new credit:

> . . . the promotion of adoption is one of the most important things we can do to strengthen American families. All children, regardless of age, sex, ethnicity, and physical and emotional health, are entitled to a family. Adoption enables children whose parents cannot or will not raise them to become part of a permanent family. Furthermore, it serves as a second chance for the thousands of children who have been removed from their families because of abuse or neglect.
>
> The high cost of adoption can be an impediment to many families wanting to adopt. With the inclusion of legal fees, court costs and charges levied by adoption agencies, the cost of an adoption can exceed $15,000. This is a heavy burden for America's low- and middle-income families who desire to adopt. The $5,000 adoption tax credit included in this may make the difference between a child in foster care becoming part of an adoptive family or remaining in foster care indefinitely.[24]

The amount of the adoption credit was increased over time, but prior to 2010, the credit was not refundable. Any credit amount in excess of a family's tax liability could only be carried forward to other years, which meant it was of less immediate value to families of moderate means. In 2008, for example, the credit was $11,650, but only households without any other dependents and earning more than $101,250 would have sufficient tax liability to absorb the full value.[25] Taxpayers of more moderate means could not recover the costs of adoption in the year they sustained them, but were forced to recoup their costs over a period of up to five years.

In 2010, as part of the Patient Protection and Affordable Care Act, Congress increased the maximum credit to $13,170 per child and made it fully refundable for the 2010 and 2011 TYs.[26] This meant that even taxpayers who had no tax liability in 2010 or 2011 (or whose

24 Remarks of Hon. Louis Stokes, 142 Cong. Rec. E787 (May 10, 1996). The Adoption Credit first appeared in the Adoption Promotion and Stability Act of 1996, H.R. 3296, 104th Cong., (1996), and was rolled into the Small Business Job Protection Act of 1996, which provided for a nonrefundable credit for adoption expenses not to exceed $5,000, or $6,000 for children with special needs. Pub. L. No. 104-188, 110 Stat. 1755 (codified as amended in 19 U.S.C., 26 U.S.C., 29 U.S.C., and 42 U.S.C.). A child has special needs if the child is a U.S. citizen or resident, a State determines that the child cannot or should not be returned to his or her parent's home, and a State determines that the child probably will not be adopted unless assistance is provided. IRC § 36C(d)(3).

25 See Nathanial S. Hibbin, *The Inequitable Tax Benefits of Adoption*, 4 Liberty Univ. L. Rev. 135, 148-9 (Fall, 2009).

26 This amount increased to $13,360 in 2011 due to inflation adjustments. The credit begins to phase out for taxpayers with modified adjusted gross income of $185,210 and phases out completely when modified adjusted gross income exceeds $225,210. Pub. L. No. 111-148, § 10909, 124 Stat. 119 (2010) (codified in IRC §36C); IRS, Tax Topics, *Topic 607: Adoption Credit and Adoption Assistance Programs for 2010 and 2011 available at* http://www.irs.gov/taxtopics/tc607.html (last visited Nov. 15, 2012).

liability was less than their credit amount) could receive the credit as a refund.[27] For those adopting a child with special needs, the credit is available in the year in which the adoption becomes final, regardless of the expenses (if any) the taxpayer actually incurred in connection with the adoption.[28] The credit is complex and has different eligibility rules depending on the type of adoption: domestic, foreign, or special needs.[29]

To qualify for the adoption credit, an individual must have adopted a child and paid qualified expenses related to the adoption (for non-special needs adoptions). Qualified expenses are those reasonable and necessary and directly related to the legal adoption of an eligible child.[30] These expenses include court costs, attorney fees, and travelling expenses.[31] To claim the credit, taxpayers must file Form 8839, *Qualified Adoption Expenses,* with their tax return and attach the required documentation.

As shown in Table 1.7.2, the number of taxpayers claiming the adoption credit and the total amount of credit claimed increased dramatically after the expansion of the credit.

TABLE 1.7.2, Adoption Credit Claims by Tax Year

	2008[32]	2009[33]	2010[34]	2011[35]
Number of Claims Filed	89,134	81,430	110,591	51,539
Total Amount Claimed	$354.5 million	$280.6 million	$1.2 billion	$668.1 million

27 The refundability of the credit expired on Dec. 31, 2011, and the credit has reverted to a nonrefundable credit of up to $12,650 for tax year 2012. Rev. Proc. 2011-52. For 2013 and beyond, the credit will be available only for special needs adoptions and may only be claimed for qualified expenses incurred up to a maximum of $6,000. Economic Growth and Tax Reconciliation Act of 2001, Pub. L. No. 107-16, raised the limit of the original credit to $10,000 and does not apply to taxable years beginning after Dec. 31, 2012.

28 IRC § 36C(a)(3). The credit available to taxpayers who adopt children who do not have special needs is the lesser of the qualified adoption expenses they paid or incurred or the statutory maximum.

29 Taxpayers may claim the adoption credit for a child who is a U.S. citizen or resident (U.S. child), children with special needs, or a foreign child. IRS Instructions for Form 8839, *Qualified Adoption Expenses* (Dec. 30, 2011).

30 An eligible child for the purposes of claiming the adoption credit is an individual who has not attained age 18, or is physically or mentally incapable of caring for him/herself. IRM 4.19.15.7.1, (Nov. 29, 2011).

31 For a detailed discussion of qualified expenses, see Instructions to Form 8839, *Qualified Adoption Expenses*. If the individual attempts to adopt a non-special-needs child within the United States, he or she may be able to claim the credit even if the adoption does not become final. If the adopted child is a U.S. citizen or resident of the United States and has special needs, the individual may qualify for the full amount of the Adoption Credit once the adoption is final, even if he or she paid few or no adoption-related expenses.

32 IRS Statistics of Income (SOI) Bulletin, *Individual Income Tax Returns, Preliminary Data 2009* Figure A, Page 9 (Winter 2010).

33 IRS SOI Bulletin, *Individual Income Tax Returns, Preliminary Data 2010* Figure A, Page 8 (Winter 2011).

34 IRS, IMF, Transaction History File, Transaction Code 766 with a Credit Reference Number 261 for tax year 2010 returns processed in calendar year 2011 from Compliance Data Warehouse (Nov. 2012).

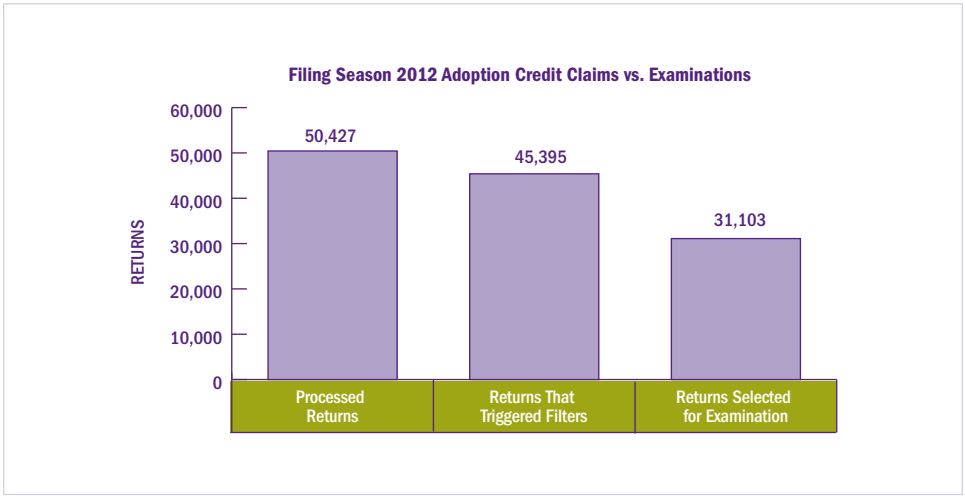
35 IRS, IMF, Transaction History File, Transaction Code 766 with a Credit Reference Number 261 for tax year 2011 returns processed in calendar year 2012 from Compliance Data Warehouse (Nov. 2012).

While the refundable portion of the credit has expired, and the credit for non-special needs adoptions ends after TY 2012, there have been efforts to extend the refundable credit.[36] Regardless of whether the refundable adoption credit is extended, the credit for individuals who adopt special needs children is permanent. Therefore, this discussion remains relevant as the IRS must continue to administer some portions of the adoption credit, particularly those impacting low income families.

Increased Audit Rate Burdens Both Taxpayers and the IRS and Offers Little Benefit

Given the refundability of the adoption credit and the dollars at stake, the IRS appears to have focused its efforts on enforcement and trying to stop potentially false or fraudulent credit payments rather than educating potentially eligible taxpayers and helping them claim the credit correctly. The IRS itself has admitted that it is "being very careful because it's a big chunk of money."[37] As a result, 69 percent of adoption credit claims were subject to examination in filing season 2012.[38]

FIGURE 1.7.3, Filing Season 2012 Adoption Credit Claims vs. Examinations[39]



36 H.R. 4373, Making Adoption Affordable Act of 2012, 112th Congress 2nd Sess. (Apr. 2012). S. 3616, Making Adoption Affordable Act of 2012, 112th Congress 2nd Sess. (Sept. 2012). In addition to legislative efforts to extend the credit, a similar proposal was included in the president's FY 2013 budget. Department of Treasury, *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals*, 198 (Feb. 2012).

37 Rosemary Parker, *Internal Revenue Service Failed to Pay Refunds for Adoption Credits on Tax Returns, Families Say*, MLive, *available at* http://www.mlive.com/news/index.ssf/2011/04/internal_revenue_service_faile.html (Apr. 1, 2011) (last visited Oct. 26, 2012).

38 Out of all processed returns with an adoption credit claim. *IRS Production Report, Adoption* Credit Compliance Filters Report Through Cycle 2012-38 (through Sept. 14, 2012). Includes late filed 2010 returns as well as 2011 returns. IRS 7-day response (Nov. 29, 2012).

39 IRS Production Report, *Adoption Credit Compliance Filters Report Through Cycle 2012-38* (through Sept. 14, 2012). Includes late-filed 2010 returns as well as 2011 returns.

IRS Adoption Credit Filters Are Flawed.

Of the tax returns that were subject to additional review, 26 percent of the delayed returns in FY 2012 were due to missing, invalid, or insufficient documentation.[40] The IRS subjected all adoption credit claims with missing or potentially invalid documentation to correspondence audit. Seventy nine percent of all adoption credit correspondence examinations in filing season 2012 involved problems with documentation.[41]

In addition to documentation issues, over one-third of filter breaks in FY 2012 were caused by income issues.[42] The credit was designed, in part, to help offset the cost of adoption, and statistics show that a significant portion of individuals who adopt are lower and middle income. Yet the IRS still chose to create an income-based filter that flags the returns of the exact taxpayers the credit was designed to assist.

Despite the high number of audits, over 55 percent of adoption credit claims resulted in no change to the taxpayers' accounts during FY 2012.[43] *This means that more than 55 percent of taxpayers selected for audit were forced to wait 18 weeks for their refunds while the IRS verified that they were in fact entitled to the amount of the credit they claimed on their returns.*[44] The median refund amount involved in these audits is over $15,000 and the median AGI of the taxpayers involved is about $64,000.[45]

Examination Delays Burden Taxpayers.

As with other refundable credits, once selected for examination, the IRS holds the adoption credit portion of the refund until it completes the exam process. According to the IRS, the average correspondence audit for adoption credit cases took 126 days in FY 2012. This was up from 83 days in FY 2011.[46] As a result, many taxpayers experienced delays in receiving their adoption credit — which was a potentially sizeable amount of money. In TY 2011, $332 million in refunds were delayed as a result of adoption credit audits.[47] This amounts to half of the $668.1 million in total adoption credit claims during the same period.[48] Some taxpayers may have been waiting on this money to help pay adoption expenses, and

40 IRS Production Report, *Adoption Credit Compliance Filters Report Through Cycle 2012-38* (through Sept. 14, 2012). Includes late-filed 2010 returns as well as 2011 returns. A single claim can trip more than one filter.

41 W&I response to TAS research request (Nov. 28, 2012). This includes missing, invalid, or insufficient documentation. Numbers shown are for tax year 2011 returns filed in 2012 (through Oct. 12, 2012), down slightly from 80 percent with missing, invalid, or insufficient documentation in TY 2010.

42 IRS Production Report, Adoption Credit Compliance Filters Report through Cycle 2012-38 (through Sept. 14, 2012). Includes late-filed 2010 returns as well as 2011 returns.

43 IRS Compliance Data Warehouse AIMS FY 2011 and 2012 (Nov. 2012). The no change rate was 80 percent in FY 2011.

44 IRS, Compliance Data Warehouse AIMS, Project codes 0355, 1067 and 0981 for FYs 2011 and 2012 (Nov. 2012).

45 IMF, Transaction History File, Transaction Code 766 with a Credit Reference Number 261 for tax year 2011 returns processed in calendar year 2012 and Individual Returns Transaction File tax year 2011 from Compliance Data Warehouse (Nov. 2012). The median refund amount is $15,446 and the median AGI is $64,839 for tax year 2011.

46 IRS, Compliance Data Warehouse AIMS, Project codes 0355, 1067 and 0981 for FYs 2011 and 2012 (Nov. 2012).

47 W&I response to TAS research request (Nov. 16, 2012). This includes adoption credit refunds held. Amounts are rounded to the nearest million. In tax year 2010, $850 million in refunds were delayed.

48 IRS IMF, Transaction History File, Transaction Code 766 with a Credit Reference Number 261 for tax year 2010 returns processed in calendar year 2011 and tax year 2011 returns processed in calendar year 2012 from Compliance Data Warehouse (Nov. 2012).

many expressed their frustration through Facebook, blogs, and tax software forums.[49] One taxpayer complained:

> Filed Federal taxes in Feb. Got half of it back with a letter saying it was under review but I didn't need to send anything further. Got another letter a month later saying I needed to include a copy of the finalization (which had been included in the first round) and a "designation of special needs" letter from the county...which I can't get. We had originally sent paperwork from our adoption file that showed our child was special needs, but apparently they want a specific letter from the county. We have spent 3 months trying to get the county to return our call... So how am I supposed to get a letter from the county when the county doesn't know what they want and now won't return my calls?[50]

Since 2011, the TAS Systemic Advocacy Management System (SAMS) received 39 issue submissions related to the adoption credit. The overwhelming majority of issues involved delays in processing adoption credit claims.[51] In addition to alerting TAS to the delays, many taxpayers came to TAS for case assistance. For TYs 2010 and 2011, TAS has received over 9,400 cases involving the adoption credit.[52] Of the cases TAS has closed, 86 percent were closed with the taxpayer receiving either full or partial relief.[53] In fact, 83 percent of taxpayers received full relief, which is significantly higher than the IRS's overall no change rate in its adoption credit cases.

IRS's Adoption Credit Cost the IRS Valuable Resources.

As noted earlier, the vast majority of adoption credit claims were due to missing or potentially invalid documentation. Rather than picking up the phone and calling taxpayers to request the missing documentation, the IRS simply sent these returns to the correspondence exam unit. The IRS has a limited pool of correspondence exam resources, a portion of which were spent on adoption credit cases. However, the data show that very few of these cases resulted in additional tax. While the complexity of the adoption credit may mean that these cases may take longer to work, the no change rate demonstrates that the IRS's

49 There are groups on FaceBook — Adoption Tax Credit/Refund Problems and Adoption Credit Stories — dedicated to discussing problems related to the adoption tax credit.

50 Rosemary Parker, Adoption Tax Credit Facebook Page Generates Stories of Snarled Returns, MLive, available at http://www.mlive.com/news/kalamazoo/index.ssf/2011/06/adoption_tax_credit_facebook_p.html (June 24, 2011) (last visited Oct. 26, 2012). The North American Council on Adoptable Children encourages people to share their experiences on their FaceBook page. Taxpayers noted countless problems with receiving the credit, including delays and duplicate requests for documentation. One taxpayer noted, "Ours is currently in the review process. They asked for additional documents...the same ones we submitted originally." North American Council on Adoptable Children FaceBook page, *available at* www.facebook.com/NACACadoption (last visited Oct. 25, 2012). The National Taxpayer Advocate has previously raised objections to the IRS's use of the term "review" in its notices, as opposed to the term "audit" because it leaves many taxpayers unaware that their return in being examined. As we have previously noted, "'review' or 'exam' may confuse taxpayers, but 'audit' is always clear." National Taxpayer Advocate 2011 Annual Report to Congress 84 (Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*).

51 Data obtained from SAMS (Nov. 2, 2012). Analysis was of SAMS submissions from January, 2011 through October, 2012. SAMS is a database of systemic tax issues and information submitted by IRS employees and the public.

52 Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Nov. 1, 2012).

53 *Id.*

case selection mechanism is flawed. Rather than allowing the correspondence exam group to work its traditional inventory — which has a no change rate of 15 percent in FY 2012 – the IRS's overreaction to the size and refundability of the adoption credit created a drain on resources that would have been better spent on other cases.[54]

Of the $668.1 million in adoption credit claims in TY 2011 as a result of adoption credit audits, the IRS only disallowed $11 million — or one and one-half percent — in adoption credit claims.[55] However, the IRS has also had to pay out $2.1 million in interest in TY 2011 to taxpayers whose refunds were held past the 45-day period allowed by law.[56] For FY 2012, the average audit results for adoption credit audits were $1,727 compared with the overall correspondence exam average results of $7,421 for FY 2011.[57]

These meager revenue savings came at the expense of a disproportionate share of IRS correspondence exam resources, compared with the overall number of claims. GAO noted that adoption credit claims represent less than one-tenth of one percent of all individual returns for the 2011 filing season. By comparison, the IRS spent approximately 3.5 percent of its staff days on initial review and correspondence audit of adoption credit claims.[58] Additionally, the IRS reported to GAO that it did not find any fraudulent adoption credit claims or refer any cases to Criminal Investigation.[59]

Documentation Issues Cause Significant Problems for Taxpayers and the IRS.

As noted earlier, for the 2012 filing season, the IRS selected 69 percent of adoption credit claims for correspondence audit — 79 percent of which involved missing or insufficient documentation.[60] Thirty-five percent of all 2011 adoption credit returns filed during the 2012 filing season had no documentation attached.[61] The GAO noted a similar — but much more severe — problem in its review of the adoption credit during the 2011 filing season.[62]

54 IRS Compliance Data Warehouse AIMS FY 2012 (Nov. 2012).

55 W&I response to TAS research request (Nov. 16, 2012). Of the $1.1 billion in adoption credit claims in tax year 2010 as a result of adoption credit audits, the IRS disallowed $115 million – or ten percent – in adoption credit claims. IMF, Transaction History File, Transaction Code 766 with a Credit Reference Number 261 for tax year 2010 returns processed in calendar year 2011 and tax year 2011 returns processed in calendar year 2012 from Compliance Data Warehouse (Nov. 2012).

56 IMF, Transaction History File, Transaction Codes 770, 771, 772, 776, and 777 for FYs 2011 and 2012 Adoption Credit Audits in Project Codes 355 and 423 on AIMS from Compliance Data Warehouse (Nov. 2012). IRC § 6611. For a timely filed return, the IRS must pay any overpayment within 45 days from the due date of the return, or pay interest as established in IRC § 6621.

57 IRS Compliance Data Warehouse AIMS FY 2012 Project Codes 355 and 423 (Nov. 2012); IRS, Data Book 2011 Table 9a Enforcement Coverage Page 22.

58 GAO, GAO-12-98, *Adoption Tax Credit* (Oct. 2011). The 3.5 percent represents a total of 28 staff days. The IRS spent a total of 23,525 staff days on all correspondence exams in FY 2012. W&I response to TAS research request (Nov. 16, 2012) (extrapolation of 2,940.59 FTEs/Staff Years into staff days).

59 GAO, GAO-12-98, *Adoption Tax Credit* 10 (Oct. 2011).

60 IRS Production Report, Adoption Credit Compliance Filters Report Through Cycle 2012-38 (through Sept. 14, 2012). Includes late-filed 2010 returns as well as 2011 returns. IRS 7-day response (Nov. 29, 2012). W&I response to TAS research request (Nov. 28, 2012). Numbers shown are for tax year 2011 returns filed in 2012 (through Oct. 12, 2012), down slightly from 80 percent with missing, invalid, or insufficient documentation in TY 2010.

61 W&I response to TAS research request (Nov. 16, 2012).

62 GAO, GAO-12-98, *Adoption Tax Credit* 10 (Oct. 2011).

Taxpayers Are Forced to Navigate Complex Documentation Rules.

The adoption credit requires taxpayers to provide substantiation at the time they file their returns — in the form of an adoption order or decree. When it first enacted the credit, Congress intended to require taxpayers "to provide *available* information about the name, age, and taxpayer identification number of each adopted child." (Emphasis added.)[63] There was concern that even these minimal requirements might prove burdensome:

> The conference committee is concerned that problems may arise in processing tax returns of adopting parents because of unavoidable delays involved in obtaining a social security number of a child who is being adopted. The conference understands that the Internal Revenue Service recognizes these concerns and is committed to working with the Congress to develop as soon as possible an administrative solution that *minimizes the burdens imposed on adopting parents* while balancing processing and potential compliance considerations.[64] (emphasis added)

As shown in Figure 1.7.4, the type of documentation varies depending on whether the adoption was foreign or domestic, final or in-process, and the special needs status of the child. Failure to provide documentation means the taxpayer's return will automatically be subjected to a correspondence audit.[65]

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63 H.R. Conf. Rep. No. 104-737, 104th Cong., 2nd Sess. 1996, sec. 1807, accompanying H.R. 3448, the Small Business Job Protection Act of 1996. The substantiation provisions, which have remained the same, were:

> (2) Taxpayer must include TIN.-
>
> (A) In general. – No credit shall be allowed under this section with respect to any eligible child unless the taxpayer includes (if known) the name, age, and TIN of such child on the return of tax for the taxable year.
>
> (B) Other methods. – The Secretary may, *in lieu of the information referred to in subparagraph (A)*, require other information meeting the purposes of subparagraph (A), including identification of an agent assisting with the adoption. (Emphasis added.)
>
> IRC § 23(f)(2). Subsection (h) provided, and continues to provide: "Regulations. – The Secretary shall prescribe such regulations as may be appropriate to carry out this section and section 137 [pertaining to adoption assistance programs], including regulations which treat unmarried individuals who pay or incur qualified adoption expenses with respect to the same child as 1 taxpayer for purposes of applying the dollar limitation in subsection (b)(1) of this section and in section 137(b)(1)."

64 H.R. Conf. Rep. No. 104-737, 104th Cong., 2nd Sess. 1996, sec. 1807, accompanying H.R. 3448, the Small Business Job Protection Act of 1996.

65 This is a result of the IRS's enforcement efforts and is not a requirement of the statutory language. Some IRS examinations are conducted entirely by mail, and these examinations are known as correspondence exams. If the examination is conducted by mail, a letter is issued to the taxpayer asking for additional information about certain items shown on the tax return. Publication 3498 *The Examination Process*, (Nov. 2004).

FIGURE 1.7.4, Documentation Requirements for Adoption Credit[66]

List of documents that need to be attached to your TY 2011 return if you are claiming Adoption Credit		
If	And	Then attach a copy of
Domestic Adoption *(Note: If the eligible child is a U.S. child, the adoption is a domestic adoption. A U.S. child is an eligible child who was a citizen or resident of the U.S. (including U.S. possessions) at the time the adoption effort began).*	In-Process	One or more of the following documents: ♦ A home study completed by an authorized placement agency ♦ A placement agreement with an authorized placement agency ♦ A document signed by a hospital official authorizing the release of a newborn child from the hospital to you for legal adoption ♦ A court document ordering or approving the placement of a child with you for legal adoption ♦ An original affidavit or notarized statement signed under penalties of perjury from an adoption attorney, government official or other authorized person, stating that the signer: a. Placed or is placing a child with you for legal adoption, or b. Is facilitating the adoption process for you in an official capacity, with a description of the actions taken to facilitate the process. *NOTE:* By its nature, either an in-process or an attempted/failed domestic adoption of a U.S. child is harder to prove than a final adoption. Notice 2010-66 contains a list of acceptable documentation, but the list is not intended to be exclusive. The adoption credit is allowable if the taxpayer can establish, by satisfactory evidence, that he or she paid qualified adoption expenses in connection with an in-process or an attempted/failed domestic adoption.
Domestic Adoption	Final	The adoption certificate, order, judgment or decree clearly establishing that the adoption is final. Showing the names of the adoptive child and parent (yourself) and signed and dated by a representative of a state or county court, showing the official seal.
Foreign Adoption *(Note: If the eligible child is a foreign child, the adoption is a foreign adoption. A foreign child is an eligible child who was not a citizen or resident of the U.S. (including U.S. possessions) at the time the adoption effort began.)*	In-Process	The adoption credit cannot be claimed.
Foreign Adoption *(from a country governed by the Hague Convention)*	Final	One or more of the following: The Hague Adoption Certificate (Immigrating Child) ♦ The IH-3 visa, or ♦ a foreign adoption decree translated into English.
Foreign Adoption *(from a country that is not a party to the Hague Convention)*	Final	One or more of the following documents: ♦ A foreign adoption decree translated into English; or ♦ An IR-2 or IR-3 visa.
Domestic Adoption *(special needs child)*	Final	The following documents: ♦ An adoption certificate, report or final decree clearly reestablishing that the adoption is final, showing the names of the adoptive child and parent (yourself) and signed and dated by a representative of the state court, *and* ♦ A copy of the state's determination of special needs, which may include, but is not limited to the following: a. A signed adoption assistance or subsidy agreement issued by the state. b. Certification from the state or a county welfare agency verifying that the child is approved to receive adoption assistance. c. Certification from the state or a county welfare agency verifying that the child has special needs.

The documentation that certifies adoptions varies from state to state. A determination of whether a child is considered to have special needs is also a state-based decision. The result

66 http://www.irs.gov/Individuals/Adoption-Credit-Documentation-Requirements.

is a variety of documentation that may meet the requirements for the adoption credit. As we have seen with the Earned Income Tax Credit (EITC), when taxpayers are required to provide non-standardized documentation to establish eligibility, it often leads to problems for both taxpayers and the IRS.[67]

The IRS is Unable to Quickly Address Documentation Issues or Identify Whether Provided Documentation is Sufficient.

As noted earlier, Congress specifically stated that it wanted to minimize the burden on adoptive parents when it imposed documentation requirements. However, the IRS's action in automatically sending claims that lack sufficient documentation to correspondence exam is the exact opposite of Congress's intent. The IRS could develop a way to quickly reach out to taxpayers to address the documentation problem, but instead chose the more burdensome and time-intensive approach. Once again, the IRS failed to look at the impacted taxpayers and design a compliance strategy around their particular needs and characteristics. Instead, it relied on its traditional processes and increased burden for taxpayers and its own employees.

While some taxpayers simply failed to provide any documentation, the IRS experienced problems identifying whether documentation was sufficient. In its audit, GAO spoke with adoption agency representatives that "acknowledged that IRS examiners faced challenges in identifying what documentation would be acceptable as proof of special needs status in each state."[68]

The National Taxpayer Advocate is encouraged that the IRS took steps to update training materials for examiners and provide examples of acceptable assistance agreements for most states. However, the IRS failed to provide the same documentation samples to taxpayers and practitioners. In its response to the GAO audit, the IRS claimed such examples could lead to fraud. As GAO noted, even if someone used the sample documentation to file a fraudulent adoption credit claim, the person still needs to provide sufficient proof of adoption expenses to qualify for the credit. The sample documentation — on its own — is not sufficient to result in a fraudulent claim. Given the significant percentage of adoption credit audits that result from documentation problems and the costs to both taxpayers and the IRS — the benefits of providing sample documentation clearly outweigh the risks.

Additionally, given the difficulties the IRS experiences with the various third-party forms, the IRS should develop a standard affidavit form that taxpayers could complete and have signed and certified by a designated official, to establish the critical information needed to

67 National Taxpayer Advocate 2007 Annual Report to Congress 94-116 (Study: *EIC Audits – A Challenge to Taxpayers*); National Taxpayer Advocate 2006 Annual Report to Congress 289-310 (Most Serious Problem: *Correspondence Exams*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2002 Annual Report to Congress 47-54 (Most Serious Problem: *EITC Eligibility Determination Can Be Made Less Burdensome*); National Taxpayer Advocate 2002 Annual Report to Congress 75-80 (Most Serious Problem: *The Length of EITC Audits Contributes to Taxpayers Concerns*); National Taxpayer Advocate 2002 Annual Report to Congress 81-87 (Most Serious Problem: *EITC Recertification Compounds Taxpayer Burden*).

68 GAO, GAO-12-98, *Adoption Tax Credit* 9 (Oct. 2011).

establish eligibility for the credit. The IRS has undertaken similar efforts with the affidavit designed for the EITC pre-certification study.[69] Generally, this pilot program found affidavits more reliable than traditionally accepted documents: "Affidavits were believed to be easier for taxpayers to obtain than official documents or letters. The results show that affidavits had a higher acceptance rate than the other two types of documents."[70]

Additionally, as observed by GAO, the IRS failed to adequately cooperate with state adoption agencies when it identified problems with documentation.[71] By failing to work closely with state agencies, the IRS missed an opportunity to connect with the impacted population in order to learn what documentation was most easily available and least burdensome and to inform them about the final documentation requirements. The IRS needs to capitalize on partnerships to provide information to taxpayers when it identifies a particular problem. By failing to engage in proactive outreach, the documentation problems continued to plague taxpayers and the IRS.

The IRS Failed Taxpayers By Not Engaging in Proactive Outreach.

The adoption tax credit is a unique refundable credit in that the eligible population is somewhat small and — if the IRS were willing to commit the time and limited resources — relatively easy to identify. Many adoptions take place through state agencies, which have direct contact with eligible taxpayers and are highly incentivized to help eligible taxpayers receive the credit. Additionally, because of the nature of adoption, countless adoption groups have direct contact with adoptive parents. By partnering with state agencies and adoption groups, the IRS would have a direct line to eligible taxpayers. The IRS could have capitalized on these connections to educate taxpayers about the credit and reached out to these same groups to help resolve problems with documentation.

Initially, the IRS's limited outreach efforts involved posting information to the IRS website.[72] The National Taxpayer Advocate is pleased that in 2012, the IRS offered two phone forums with state agencies and adoption agencies, allowing them to call in and ask

69 IRS, *IRS Earned Income Tax Credit (EITC) Initiatives, Addendum to the Report on Qualifying Child Residency, Certification, Filing Status, and Automated Underreporter Tests: Implementation of Alternative Approaches to Improving the Administration of EITC* (2008); IRS, *IRS Earned Income Tax Credit (EITC) Initiative: Final Report to Congress* (Oct. 2005).

70 *See IRS Earned Income Tax Credit (EITC) Initiatives: Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests* 8, 14 (2008). TAS has also been working with the IRS on a three-year study related to third-party affidavits to demonstrate the residency of qualifying children during EITC audits. For more information on the 2005 pilot and a more recent TAS-IRS study on affidavits, see National Taxpayer Advocate 2011 Annual Report to Congress 304-305 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*). While current audit procedures allow taxpayers to provide either official records or letters on official letterhead to document the residence of a child, this pilot program gives the taxpayer the option of using another type of documentation – a third-party affidavit. This procedure allows third-parties with knowledge of the child's residency to fill out a standardized affidavit rather than write a letter. The affidavit would be signed under penalties of perjury and list the affiant's title, agency, and contact information. The affidavit would also contain a third-party contact notification alerting the taxpayer that the IRS may contact the affiant. When questionable claims arise, the IRS can contact the affiant to verify the accuracy of the information.

71 GAO, GAO-12-98, *Adoption Tax Credit* 8 (Oct. 2011).

72 See Tax Tips, *available at* http://www.irs.gov/uac/Tax-Tips-for-2012-1 (last visited Nov. 14, 2012).

questions about the credit.[73] However, this outreach was not proactive — it placed the burden on the adoption groups to contact the IRS to receive information.[74] The IRS partners with stakeholders on an annual outreach campaign for the Earned Income Tax Credit, which kicks off with EITC Awareness Day.[75] The adoption community launched a similar effort — Adoption Tax Credit Awareness Day — to make adoptive families aware that the credit exists.[76] This would have been a perfect opportunity for the IRS to capitalize on an already planned outreach effort in order to reach impacted taxpayers.

Inability to e-File Adoption Credit Returns Causes Delay for Both Taxpayers and the IRS.

Taxpayers claiming the adoption tax credit can no longer file their returns electronically because the IRS requires paper documentation on Form 8839, *Qualified Adoption Expenses*. The prohibition on e-filing is burdensome to taxpayers who must now file paper returns. Additionally, it causes delay for both taxpayers and the IRS due to processing times and an inability to identify problematic returns more easily. E-filing capabilities for adoption credit returns would:

- Address some of the documentation problems and audit delays discussed previously;
- Require taxpayers to attach documentation to their returns before they could be submitted, reducing the number of returns submitted without documentation; and
- Allow the IRS to identify claims without supporting documentation earlier in the process, preventing delays for both taxpayers and the IRS.

The issue of electronic filing for credits involving additional documentation is not new for the IRS. The IRS faced this problem with the First-Time Homebuyer Credit (FTHBC) and TAS repeatedly raised this issue.[77] While the expanded adoption credit may have brought with it additional documentation requirements, the IRS once again failed to consider the

73 IRS, *March 2012 Adoption Credit Phone Forums Questions and Answers, available at* http://www.irs.gov/Individuals/Adoption-Credit-Phone-Forum-Questions-and-Answers (last visited Nov. 2, 2012).

74 For a discussion of the National Taxpayer Advocate's concerns about the IRS approach to taxpayer education, see Most Serious Problem: *The IRS Is Substantially Reducing Both the Amount and Scope of its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of its Remaining Outreach Activities, Thereby Risking Increased Noncompliance, infra*.

75 IRS, *On Earned Income Tax Credit Awareness Day, IRS and Partners Launch Outreach Campaign to Low- and Moderate-Income Workers*, IR-2012-11 (Jan. 27, 2012).

76 Washington State Department of Social & Health Services, *Adoption Tax Credit Awareness Day, available at* http://www.dshs.wa.gov/ca/fosterparents/newstaxcredit.asp (last visited Oct. 24, 2012).

77 National Taxpayer Advocate 2011 Annual Report to Congress 687-689 (Case Advocacy: *Policymakers Can Learn from the Implementation of the FTHBC*); National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 28-32; National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*) (Case Advocacy: *TAS Assists the IRS with the Administration of the First-Time Homebuyer Credit*); National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress 3, 37-43; National Taxpayer Advocate 2009 Annual Report to Congress 506-509; *Hearing on Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due, Hearing Before the S. Comm. on Finance*, 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (June 28, 2011); *Filing Season Update: Current IRS Issues: Hearing Before the S. Comm. on Finance*, 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Apr. 15, 2010); *The National Taxpayer Advocate's 2009 Report on the Most Serious Problems Encountered by Taxpayers: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Mar. 16, 2010).

impact of requiring taxpayers claiming this credit to file paper returns. TAS and GAO have both noted the importance of e-filing in improving the administration of the adoption credit.[78] The Taxpayer Advocacy Panel (TAP), in its review of issues surrounding the adoption credit, recommended the IRS allow e-filing of adoption credit returns.[79]

Many of the Adoption Problems Could Have Been Minimized by Considering Administrative Issues Unique to Refundable Credits.

The National Taxpayer Advocate has previously noted that compliance issues with refundable credits often stem from the design of the credits, including

- Identification of the targeted population;
- Use of data to determine eligibility;
- Use of third-party affidavits; and
- Responsiveness of the IRS in administering the credit.[80]

The available data makes it clear that the IRS took none of these facts into account in administering the credit. Had the IRS worked closely with stakeholders to understand the target population, it could have designed more targeted filters. The IRS's no change rate demonstrates that the current filters have problems — problems that could have been minimized if the IRS had revised its filters once it learned they were disproportionately catching accurate claims, burdening taxpayers, and straining IRS resources.

The IRS's Implementation of the Expanded Adoption Credit Does Not Bode Well for its Implementation of the Premium Tax Credit.

The adoption credit was not the only refundable credit in the Patient Protection and Affordable Care Act. The Premium Tax Credit, which goes into effect in 2014, has the potential to be one of the largest refundable credits the IRS has had to administer. The Premium Tax Credit raises the same potential for documentation, training, and fraud problems as the adoption credit. The IRS needs to evaluate the difficulties it encountered with the adoption credit and identify potential lessons learned that can be applied to the administration of the Premium Tax Credit. If the IRS does not take the time to learn from its adoption credit experience and be thoughtful about how it administers future refundable credits, it may face problems with the Premium Tax Credit — including high examination rates — that will overwhelm IRS resources and severely burden taxpayers.

78 National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 35-36; National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 46-47. GAO, GAO-12-98, *Adoption Tax Credit* (Oct.2011).

79 Taxpayer Advocacy Panel, *Adoption Credit Processing Recommendations* (June 2012). The Taxpayer Advocacy Panel (TAP) was created in October 2002 with the expansion of the former Citizen Advocacy Panel, first established in 1998. The TAP reports to the Secretary of the Treasury, Commissioner of Internal Revenue, and the National Taxpayer Advocate with oversight and support of the program provided by the TAP Director and staff. The TAP acts as a two-way conduit between the public and IRS. The mission of the TAP is to listen to taxpayers, identify taxpayers' issues, and make suggestions for improving IRS service and customer satisfaction.

80 National Taxpayer Advocate 2009 Annual Report to Congress 75 (Study: *Running Social Programs Through the Tax System*).

CONCLUSION

By design, the adoption tax credit plays a critical role in helping taxpayers — particularly low and middle income taxpayers — meet the financial burden that may be involved in adopting a child. The IRS, facing a sizeable refundable credit, reacted with an enforcement strategy that was focused on stopping nearly all returns claiming the credit and subjecting a large percentage of them to an audit, instead of reaching out to stakeholders (including states) to understand the impacted taxpayer population. When problems emerged, the IRS simply continued selecting returns for audit. This approach forced taxpayers to withstand lengthy delays and the IRS to expend valuable resources with very little to show for them. As the IRS faces a new refundable credit in the form of the Premium Tax Credit, it should study and learn from its mistakes to avoid repeating them again, when there will be even more at stake.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Provide examples of acceptable adoption credit documentation for taxpayers.
2. Develop a proactive outreach and education strategy that involves working with state adoption agencies or similar agencies to better understand the demographics and needs of the affected taxpayer population and address documentation issues.
3. In consultation with the National Taxpayer Advocate and external stakeholders, develop a third-party affidavit form for verification of a child's special needs status.
4. Allow e-filing of adoption tax credit returns that include substantiation in an electronic format.
5. Consider the factors for refundable credits laid out by the National Taxpayer Advocate when moving forward with the administration of the Premium Tax Credit.
6. Study the administration of the adoption credit to identify lessons that can be applied to the administration of other refundable credits, including the Premium Tax Credit.

IRS COMMENTS

The IRS modeled the adoption credit program on processes and procedures in place for other refundable credits and built upon lessons learned from our experience in administering those programs. Our programs for refundable credits emphasize outreach to taxpayers and supporting stakeholders as well as overall compliance with the tax laws. The IRS is committed to ensuring adoptive parents receive the benefits to which they are entitled, and that they understand and fulfill their tax obligations.

The IRS implemented the adoption credit program with an approach that balanced the objective of paying legitimate credits in a timely manner with that of ensuring that claims were accurate. Our experiences and lessons learned from other refundable credits taught us that high dollar credits have high risk and the potential for fraud. We must ensure

delivery of the credit to those entitled while protecting the government's interest in minimizing exposure to fraud.

As noted in the Most Serious Problem, the adoption credit environment and rules are varied and complex, making the credit challenging to administer. There are different rules for special needs, foreign, and domestic adoption options, nonqualification of expenses paid for by federal, state or local adoption grant programs, and carryforward provisions. Centralized third-party data does not exist for the IRS to validate all claims.

The IRS evaluated the risk associated with this high-dollar credit and decided to require taxpayers to attach documentation to their returns. We implemented new procedures within the IRS to review the documentation and quickly process the returns, our goal being to avoid refund delays for taxpayers who attached requested documents. We developed examination filters, based on historical filing data, characteristics of taxpayers claiming the adoption credit in the past, other research data we gathered, and lessons learned from other refundable credits. We used that information to develop our filters and adjusted as needed for new information and experience.

The IRS held monthly cross-functional meetings that included TAS representatives to review implementation of the strategy, to immediately address issues, to streamline internal processes and to cultivate servicewide best practices. This involved continual monitoring and adjustment of our examination filters. The IRS analyzed the data collected and compiled lessons learned from the first year of the adoption credit program. As a result, changes were made to examination filtering, selection processes and outreach based on a reexamination of associated risk through data captured. The changes made improved and reduced audit selections and reduced taxpayer burden.

Recognizing the taxpayer impact of holding large-dollar refunds, the IRS placed additional emphasis on processing adoption credit audits in an expeditious manner. Due to the upfront documentation requirement, the processes we put in place and the priority we assigned these cases, the cycle time for closed examination adoption cases has been significantly less than other audits. We believe the lack of fraud identified with this credit was in large part due to the documentation requirements that were implemented.

In FY 2012, we found errors in 44 percent of the returns we examined and closed, protecting revenue of almost $135.5 million. During both FY 2011 and FY 2012, we protected almost $164 million on cases closed in our examination functions. Examinations on TY (TY) 2011 returns continue, and we expect that the overall change rate and dollars assessed will continue to increase as the cases close.

As part of our effort to help adopting taxpayers understand and fulfill their tax obligations, we emphasized information on internal and external websites regarding the documentation requirement as well as the examination process. We emphasized information such as documents needed and potential consequences of not including documentation, which

could cause refund delays and subject returns to audits. We included information on expected timing, including average examination process time as well as post examination refund issuance.

In addition to the compliance part of our strategy around the adoption credit, the IRS implemented an equally important strategic communication plan for outreach. The communication strategy included collaboration with external stakeholders and extensive training for our tax examiners. The IRS coordinated with various state agencies to identify third party data that could be used to verify legitimate domestic and special needs claims. Our communication plan included outreach activities and products and guidance. We updated forms and publications, posted information on our internal and external websites, issued public service announcements, communicated with the professional preparer community and collaborated with software developers. Our goal was to ensure taxpayers, preparers, adoption organizations, and software developers who supported the taxpayers in different roles, understood the new adoption credit requirements and procedures.

When a high percentage of taxpayers did not attach required documents, the IRS immediately took action with a new communications effort. The IRS issued a Tax Tip, email blasts to adoption organizations, e-News for Tax Professionals, and a YouTube video, all of which focused on the new documentation requirement. The IRS reached out to software developers and large tax preparation firms to notify them of the documentation problem and to request their assistance. As a result, these partners improved software and issued guidance to preparers. These efforts resulted in a 40 percent improvement in the percentage of returns filed with no documentation from the 2011 to 2012 filing season.

In FY2012, based on stakeholder feedback, we expanded and further improved our outreach. In addition to making standard yearly updates for amounts and limitations, we (i) revised the Instructions and Form 8839 to include statements at the top and bottom of the form to direct taxpayers to attach required documents; (ii) developed a Tax Talk Today webcast for preparers which included information on steps preparers could take to assure eligible taxpayers receive the adoption credit; (iii) recognized National Adoption Credit Month with an IRS News Tweet with a link to irs.gov; (iv) held two Webinars with various state and private adoption agencies; and (v) posted an If/Then Chart to simplify documentation requirements for the different types of adoptions.

The IRS agrees it is important for taxpayers to understand what documentation is acceptable. However, the IRS believes while posting examples of acceptable documentation may help some taxpayers, we remain concerned that other individuals could use that information to perfect fictitious documents that they could be used to make fraudulent claims for the adoption credit. The IRS used other outreach, as explained above, to communicate with taxpayers about documentation.

The IRS agrees that, when implementing any new credit, we should use a proactive approach. We did this with the expanded adoption credit. The IRS used historical research

data and lessons learned from other refundable credits to develop and implement a strategic communication plan. This plan included extensive communication and outreach beginning in September 2010 and continuing through the present. The IRS proactively sought and established relationships with various state adoption agencies, advocacy groups and tax preparers to learn more about this unique population. This allowed us to develop key messages and target audiences as appropriate for our adoption credit communications. This process also improved our knowledge of related adoption issues. Very importantly, this approach was established early and relied on continued open lines of communication with stakeholders who communicated issues on which we immediately took action.

The IRS considered the feasibility of implementing a third party affidavit form for verification of a child's special need status and made a business decision not to do so. The states and/or counties provide special needs documentation during or after the adoption process to adoptive parents. The IRS decided to minimize burden on taxpayers and to avoid undue delays in issuing refunds by accepting the documents already available to adoptive parents. We also considered the burden to the third parties in many levels of many government agencies who would be completing the affidavits and the challenges to those agencies and to the IRS in educating the parties involved for a time-limited potential need.

The IRS investigated electronic filing and possible attachment of documentation to electronic returns for TY 2011. However, based on the expected significant decrease in the volume of adoption credit returns in 2011 (which occurred), limited e-filing capabilities, and equipment necessary, we were unable to pursue an electronic option for TY 2011. The IRS is not requiring documentation to be attached to 2012 returns when the credit becomes nonrefundable (however, as with other claims, taxpayers must maintain proof that their claim is accurate). Unfortunately, we are unable to re-implement electronic filing for the upcoming filing season, but expect to be able to allow electronic filing for future years. We will ensure that our outreach efforts to preparers and the adoption community would clearly communicate this information.

With respect to the recommendations related to the Premium Tax Credit, the IRS will consider the input of the National Taxpayer Advocate in our administration of the Premium Tax Credit while we build upon our knowledge and recent experience in implementing and administering other refundable tax credits.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS is committed to ensuring adoptive parents receive the benefits to which they are entitled. The IRS's commitment to emphasizing outreach and education and partnering with advocacy groups to understand the target population is encouraging. In addition, the IRS's efforts to share information through monthly cross-functional meetings — of which TAS was a participant — allowed a proactive approach to some compliance issues as they arose.

The rules associated with the adoption credit are complex and varied, posing a compliance challenge for the IRS. However, it is clear that the IRS failed to take into account the specific characteristics of the target population — particularly low and middle income taxpayers — when designing its examination filters. While the IRS states it took efforts to continually adjust the system, 90 percent of returns claiming the refundable adoption credit during the 2012 filing season tripped filters that select returns for examination.[81] Income-based filters were responsible for over one-third of these additional reviews.[82] The IRS clearly did not take into account the demographics of the impacted taxpayers as it designed — and adjusted — its filters. And although the IRS states that it conducted extensive research about the credit, it clearly did not read or review either the congressional record laying out Congress' focus on low and middle income families or its concerns about IRS unduly burdening credit applicants. Nor does it appear that the IRS reviewed or heeded the National Taxpayer Advocate's comprehensive analysis of and recommendations for effective administration of social programs in the Internal Revenue Code.[83]

In its response, the IRS states that "In FY 2012, we found errors in 44 percent of the returns we examined and closed, protecting revenue of almost $135.5 million." *This means that in 56 percent of its adoption credit audits, the IRS found no errors.* This no-change rate is among the highest the National Taxpayer Advocate has ever seen since she was appointed to this position. For the IRS to say, with a straight face, that this is a positive result of any audit strategy makes a mockery of effective tax administration. It also signals that the IRS continues to underestimate or ignore the true burden it placed on taxpayers who are legitimately claiming a tax benefit to which they are entitled and sorely need.

Despite the fact that taxpayers are not required to attach documentation for 2012 adoption credit claims, they still cannot electronically file these claims. The current approach causes significant additional burden on both taxpayers and the IRS. The National Taxpayer Advocate is hopeful that the IRS will change this policy for future filing seasons, as the IRS comments indicate.

81 IRS Production Report, Adoption Credit Compliance Filters Report Through Cycle 2012-38 (through Sept. 14, 2012).

82 *Id.* Includes late-filed 2010 returns as well as 2011 returns. A single claim can trip more than one filter.

83 National Taxpayer Advocate 2009 Annual Report to Congress 75 (Study: *Running Social Programs Through the Tax System*).

The National Taxpayer Advocate is disappointed that fear of possible fraudulent claims has prevented the IRS from providing sample documentation that could have eased the process of claiming the credit for taxpayers and prevented some costly, time-consuming documentation problems for the IRS. Sample documentation, on its own, is not enough to allow a fraudulent claim. While the IRS must take action to prevent fraudulent claims, it cannot allow potential fraud to also prevent eligible taxpayers from receiving much-needed guidance.

The National Taxpayer Advocate is pleased that the IRS recognizes the critical role of proactive outreach and education in ensuring the success of a refundable credit targeted to a specific group of taxpayers. We hope the IRS's efforts to develop relationships with state adoption agencies and advocacy groups in order to understand the population eligible for the adoption credit will encourage the IRS to reach out to similar groups in the future. We also are encouraged that the IRS engaged in proactive outreach when it identified documentation issues with a significant number of adoption credit claims. However, the IRS should not rely on its standard outreach procedures of working through practitioners and software developers. It must capitalize on the ability of various advocacy groups to communicate with the target population.

While the National Taxpayer Advocate is pleased that the IRS considered the use of a third-party affidavit, we are disappointed by the decision not to use this tool. The affidavit would not impose a burden on taxpayers or third parties — it is designed to be an option that taxpayers can use to meet the IRS's documentation requirements with as little burden as possible. The National Taxpayer Advocate urges the IRS to reconsider its position on the use of the third-party affidavit.

The adoption tax credit is just the first refundable credit to emerge from the Affordable Care Act. While the IRS claims its approach to the adoption credit emphasized outreach and ensuring that taxpayers received the tax credits to which they were entitled, the data indicate that this was not always the case. The National Taxpayer Advocate commits to working collaboratively with the IRS as it develops procedures to administer the Premium Tax Credit to ensure that the IRS takes a taxpayer-focused approach and does not make the same mistakes it made with the adoption credit. We encourage the IRS to consider the factors for refundable credits that we have previously outlined as it moved forward with administering the Premium Tax Credit.

Recommendations

The National Taxpayer Advocate recommends the IRS take the following actions:

1. Ensure that any examination filters take into account the congressionally-intended demographics of the affected taxpayer population and are continually monitored and updated if data demonstrate that they are catching more taxpayers than appropriate.
2. Provide examples of acceptable adoption credit documentation for taxpayers.
3. In consultation with the National Taxpayer Advocate and external stakeholders, develop a third-party affidavit form for verification of a child's special needs status.
4. Allow e-filing of adoption tax credit returns that include substantiation in an electronic format.
5. Consider the factors for refundable credits laid out by the National Taxpayer Advocate when moving forward with the administration of the Premium Tax Credit.
6. Study the administration of the adoption credit to identify lessons that can be applied to the administration of other refundable credits, including the Premium Tax Credit.

MSP #8 The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts

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DEFINITION OF PROBLEM

The Bank Secrecy Act (BSA) requires U.S. citizens and residents to report foreign accounts on Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts* (FBAR) so the government can better detect "bad actors" engaged in tax evasion, terrorism, and money laundering.[1] Beginning in 2009, the IRS initiated a series of offshore voluntary disclosure (OVD) programs to settle with taxpayers who had failed to report offshore income and file any related information return such as the FBAR: the 2009 Offshore Voluntary Disclosure Program (OVDP), 2011 Offshore Voluntary Disclosure Initiative (OVDI), and the open-ended 2012 OVDP.[2] As discussed in prior reports, these programs applied a resource-intensive, burdensome, punitive, one-size-fits-all approach designed for "bad actors" to "benign actors" who inadvertently violated the rules.[3]

While an estimated five to seven million U.S. citizens reside abroad, and many more U.S. residents have FBAR filing requirements,[4] the IRS received only 741,249 FBAR filings in 2011, and as of September 29, 2012, it had received fewer than 28,000 OVD submissions from FBAR violators.[5] Thus, significant FBAR filing compliance problems likely remain unaddressed.

1 *See generally* 31 U.S.C. § 5321(a)(5); 31 C.F.R. § 1010.350; Internal Revenue Manual (IRM) 4.26.16 (July 1, 2008); Joint Committee on Taxation (JCT), JCS-5-05, *General Explanation of Tax Legislation Enacted in the 108th Cong*. 377-78 (May 2005).

2 IRS, *Voluntary Disclosure: Questions and Answers*, http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers (first posted May 6, 2009) [hereinafter "2009 OVDP FAQ"]; IRS, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers (first posted Feb. 8, 2011) [hereinafter "2011 OVDI FAQ"]; *IRS, Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (first posted June 26, 2012) [hereinafter "2012 OVDP FAQ," or collectively the "OVD programs"].

3 National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id*. at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id*. at 21-29. *See also* Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011).

4 National Taxpayer Advocate 2009 Annual Report to Congress 144.

5 IRS response to TAS information request (July 27, 2012); IRS response to TAS information request (Sept. 23, 2012).

In addition to problems identified in prior reports, the National Taxpayer Advocate is concerned that the IRS has:

- Increased the cost and burden of correcting past violations, as well as the IRS resources required to process these corrections, by continuing to require benign actors to opt in and opt out of OVD programs — even though processing times are longer for those who opt out, averaging nearly 550 days for the 2009 program;
- Increased the burden of reporting foreign accounts in the future by requiring duplicative reporting on the FBAR and Form 8938, *Statement of Specified Foreign Financial Assets*; and
- Discontinued pilot programs to send information about the foreign account reporting requirements to people with foreign accounts.

However the IRS recently reduced the burden of correcting errors somewhat. It clarified that some taxpayers could opt out of the OVD programs without penalty. A new initiative also allows some nonresidents to correct errors outside of the OVD programs.

As the IRS receives an increasing amount of information from foreign financial institutions that will enable it to identify more FBAR noncompliance, however, it may need to devote more enforcement resources to address this noncompliance; expand its outreach and self-correction options for benign actors; or ignore the noncompliance altogether. The IRS should promote voluntary compliance by reducing compliance burdens and expanding its targeted outreach and self-correction options for benign actors.

ANALYSIS OF PROBLEM

IRS OVD programs discouraged taxpayers from self-correcting errors, burdening taxpayers and draining IRS resources.

Taxpayers may normally correct their own inadvertent violations without significant penalties or burdens.

The maximum civil penalty applicable to a bad actor for "willfully" failing to report foreign accounts on an FBAR is severe — the greater of 50 percent of the account or $100,000 per year.[6] However, the IRS does not generally apply a significant penalty to benign actors who inadvertently fail to report accounts, particularly if they voluntarily correct the violation(s) before the IRS contacts them.[7]

6 31 U.S.C. § 5321(a)(5)(C).

7 *See, e.g.*, IRM 4.26.16.4.7 (July 1, 2008). Unlike citizens of most other countries, U.S. citizens with income above certain thresholds are required to file returns with the IRS even if they reside abroad and have no net U.S. tax liability. *See, e.g.*, IRC § 6012(a)(flush) and (c). The FBAR and the new Form 8938 may help the government to detect potentially unreported income deposited in foreign accounts.

In addition, those who failed to report income could normally avoid accuracy-related penalties by filing "qualified amended returns" before being contacted by the IRS.[8] Thus, in the absence of any special IRS program, a taxpayer could correct a failure to report a foreign account and income from the account while avoiding most penalties by simply filing three (or six) years worth of returns (or amended returns) and FBARs.[9] This approach encourages voluntary compliance and self-correction, which is the IRS's stated goal.[10]

The IRS OVD programs discourage self-correction.

The IRS "strongly encouraged" everyone with an FBAR violation and unreported income (including benign actors) to participate in its OVD programs and initially discouraged them from opting out.[11] For example, IRS FAQs indicated:

> Those taxpayers making "quiet" disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years. 2009 OVDP FAQ #10; 2011 OVDI FAQ #15; 2012 OVDP FAQ #15.
>
> ***
>
> Taxpayers who do not submit a voluntary disclosure run the risk of detection by the IRS and the imposition of substantial penalties, including the fraud penalty and foreign information return penalties, and an increased risk of criminal prosecution. 2009 OVDP FAQ #3; 2011 OVDI FAQ #4; 2012 OVDP FAQ #4.
>
> ***
>
> Failing to file an FBAR subjects a person to a prison term of up to ten years and criminal penalties of up to $500,000. 2009 OVDP FAQ #14; 2011 OVDI FAQ #6; 2012 OVDP FAQ #6.
>
> ***
>
> [For those who opt out of the 2009 OVDP] All relevant years and issues will be subject to a complete examination. At the conclusion of the examination, all applicable penalties (including information return and FBAR penalties) will be imposed. Those penalties could be substantially greater than the 20 percent penalty. 2009 OVDP FAQ #34.
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> ***

8 *See* Treas. Reg. § 1.6664-2. Certain deductions and credits may be denied if returns from individuals who are not U.S. residents or citizens are more than 16 months late or if returns from foreign corporations are more than 18 months late, provided the taxpayer does not demonstrate reasonable cause for the delay. *See* IRC §§ 874(a) (applicable to individuals) and 882(c)(2) (applicable to corporations); Treas. Reg. §§ 1.874-1 and 1.882-4.

9 The statutory period for assessing additional tax is generally limited to three or six years from the date the return is filed. *See* IRC § 6501.

10 IRS Policy Statement 6-11 (Nov. 4, 1977) ("[A]dministrative procedures and forms will be designed to promote voluntary compliance."); IRS Policy Statement 20-1 (June 29, 2004); H.R. Conf. Rep. No. 101-386 at 661 (1989) ("the IRS should develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance.").

11 2009 OVDP FAQ #10; 2011 OVDI FAQ #15; 2012 OVDI FAQ #12.

> [Q] Is the IRS really going to prosecute someone who filed an amended return and correctly reported all their income? ... [A] When criminal behavior is evident and the disclosure does not meet the requirements of a voluntary disclosure under IRM 9.5.11.9, the IRS may recommend criminal prosecution to the Department of Justice. 2009 OVDP FAQ #49.

Because of these threats, many taxpayers were concerned that the IRS would always seek the maximum FBAR penalties, regardless of the situation. As described in prior reports, some benign actors were so fearful of opting out that they accepted the IRS settlement and paid more than they owed.[12] Moreover, since the Deputy Commissioner partially rescinded a Taxpayer Advocate Directive (TAD) aimed at assisting these taxpayers, and the IRS Commissioner responded to the National Taxpayer Advocate's concerns with deafening silence, TAS has observed less flexibility among IRS examiners and OVD program managers in dealing with benign actors.[13] Under these circumstances, some taxpayers are likely to ignore their problems until the IRS offers them a reasonable way to correct inadvertent errors.[14]

IRS OVD programs were burdensome for benign actors and drained IRS resources.

The OVD programs require benign actors to opt in and then opt out. OVD program participants must file (or amend) eight years of returns; wait for the IRS to process the applications; and then either (1) pay various penalties plus an "offshore" penalty equal to 20, 25, or 27.5 percent of their unreported offshore assets;[15] or (2) "opt for an examination" by "opting out" and risk unreasonably large FBAR penalties.[16]

As shown below, OVD program processing times are longer for benign actors who opt out, averaging nearly 550 days for those opting out of the 2009 OVDP.

12 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 238-41.

13 *See* Memorandum for National Taxpayer Advocate from Deputy Commissioner for Services and Enforcement, *Taxpayer Advocate Directive 2011-1* (Oct. 14, 2011); Memorandum for Commissioner of Internal Revenue from National Taxpayer Advocate, *Recommendations Regarding Taxpayer Advocate Directive 2011-1* (Sept. 26, 2011). For further discussion of this issue, see National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 8-9.

14 *See e.g.*, Alison Bennett, *Tax Evasion: Taxpayers Fear Disclosing Offshore Assets As Deadline Approaches, Practitioners Say*, 157 DTR GG-1, 2011 (Aug. 15, 2011); Robert Wood, *Should You File FBAR for the First Time?*, Forbes (June 14, 2011), http://www.forbes.com/sites/robertwood/2011/06/14/should-you-file-fbar-for-the-first-time/; Steven Mopsick, *Tax Justice for Americans Abroad: No Penalties for Prospective Compliance*, 136 Tax Notes 189 (July 9, 2012).

15 Certain taxpayers could qualify for an offshore penalty rate of 5 percent or 12.5 percent. 2011 OVDI FAQ #52 and #53; 2012 OVDP FAQ #52 and #53.

16 *See* 2011 OVDI FAQ #42; 2012 OVDP FAQ #42; 2009 OVDP FAQ #34. *But see* Memorandum from Deputy Commissioner for Services and Enforcement, *Guidance for Opt Out and Removal of Taxpayers from the Civil Settlement Structure of the 2009 OVDP and the 2011 OVDI* (June 1, 2011) ("the taxpayer should not be treated in a negative fashion merely because he or she chooses to opt out . . ."; 2012 OVDP FAQ #51 (same).

TABLE 1.8.1, OVD Program Applications, Dispositions, and Processing Time as of September 29, 2012[17]

	2009 OVDP		2011 OVDI		2012 OVDP
	Number	Average Processing Time (closed cases)	Number	Average Processing Time (closed cases)	Number
Total applicants[18]	11,161		11,941		4,095
Closed after certification	10,723	307.3 days	1,463	116.6 days	0
Open certification	63		10,417		4,095
Opted out	280		30		0
Closed after opt out	235	548.4 days	8	176.5 days	0
Open after opt out	38	647.4 days	22	173.4 days	0
Removed	105		0		0
Closed after removal	79	583.9 days	0	n/a	0
Open after removal	24	711.1 days	0	n/a	0

Although the IRS has not closed very many opt-out cases, the average civil FBAR penalty assessed against those opting out of the 2009 OVDP is only $15,737.[19] Moreover, the IRS has not initiated any criminal prosecutions against those who opted out.[20] In other words, the IRS required benign actors with minor FBAR violations to spend the time to apply to the 2009 OVDP, incur significant fees for representation, and wait for about a year and a half for the IRS to process their cases (on average), all in an effort to collect very little FBAR penalty revenue.

While benign actors would normally have made "quiet" corrections, rather than participate in the OVD programs, the IRS warned them **not** to do so. This approach left the taxpayers with no good options — and discouraged voluntary compliance — while committing the IRS to use limited enforcement resources to process a potentially large number of submissions.[21]

People with Canadian retirement plans faced additional burdens.

People with certain Canadian retirement plans who wanted to file late or amended U.S. tax returns, as required for participation in an OVD program, faced additional burdens. The IRS issued conflicting guidance about how to make a late election to exclude undistributed

17 IRS response to TAS information request (Oct. 23, 2012).

18 The number shown for the 2009 OVDP and the 2011 OVDI counts an application from a husband and wife as one application, but the number shown for the 2012 OVDP counts them as two.

19 IRS response to TAS information request (Oct. 23, 2012) (noting that $1,255,567 in willful and nonwillful penalties plus $1,671,518 in negligence penalties were assessed against taxpayers who opted out of the 2009 OVDP in 186 closed cases). Moreover, a small number of taxpayers could account for most of these penalties.

20 *Id.*

21 Although the IRS has not processed very many opt out requests, the average civil FBAR penalty assessed against those opting out of the 2009 OVDP is only $15,737 ($1,255,567 in willful and nonwillful penalties plus $1,671,518 in negligence penalties, divided by 186 closed cases). IRS response to TAS information request (Oct. 23, 2012). Moreover, the IRS has not initiated any criminal prosecutions against those who opted out. *Id.*

income from those plans.[22] Under Revenue Procedure 2002-23, if taxpayers do not make these elections by attaching them to a timely-filed U.S. income tax return, they are late, and the IRS will not accept late elections unless the taxpayer obtains a private letter ruling (PLR).[23] Some taxpayers spent significant time and resources to obtain a PLR, as shown below.[24]

TABLE 1.8.2, PLR Requests Under Section 4.06 of Rev. Proc. 2002-23, FY 2009-2012[25]

Fiscal Year	2009	2010	2011	2012
Total Requests	18	6	134	35
Average User Fee	$4,500	$1,083	$728	$1,489
Average Processing Time[26]	149 days	133 days	165 days	120 days
Number Issued	18	6	17	4
Number Denied/Returned[27]	1	0	0	0
Number Withdrawn	0	0	0	0
Number Open[28]	0	0	117	31

However, the IRM suggested that the IRS would simply process late elections without a PLR.[29] Thus, the IRS treated similarly-situated taxpayers differently.

Pursuant to 2012 OVDP FAQ #54, the IRS recently provided entirely different instructions for making late elections. Although FAQ #54 may reduce burden for some, it will confuse others, as the IRS has issued three conflicting statements about how to make a late election. This confusion is compounded by the fact that neither the taxpayer-friendly IRM nor FAQ #54 represent formal guidance. Moreover, those who have already paid to prepare a PLR submission may incur additional fees to make a different submission pursuant to FAQ #54.[30]

22 *See* Form 8891, *U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans.*

23 Rev. Proc. 2002-23, 2002-1 C.B. 744.

24 To put these figures in context, a Westlaw search revealed the IRS issued only 1,487 PLRs in 2011.

25 IRS response to TAS information request (July 25, 2012).

26 Processing time reflects the days in inventory for rulings issued during the year.

27 One PLR request was returned because it was not necessary.

28 The open cases were suspended pending resolution of consistent treatment under the OVDI program. We understand the IRS is returning the user fees.

29 Rev. Proc. 2002-23, §§ 4.01 and 4.06, 2002-1 C.B. 744; Treas. Reg. §§ 301.9100-1 and -3; IRM 21.5.3.4.9.1 (Aug. 4, 2009) ("For retroactive elections... Process the amended return as normal."). The IRS does not track the number of Form 8891 submissions or the number processed late. IRS response to TAS information request (July 27, 2012).

30 *See* Marie Sapirie, *Frustration Grows for Canadians in OVDI*, 2012 Tax Notes Today 169-1 (Aug. 29, 2012).

The IRS has recently reduced the burden of correcting errors for some taxpayers.

The IRS issued a "fact sheet," clarifying that nonresidents who opt out of the OVD programs will not always face penalties.

In December 2011, the IRS clarified that, for nonresidents, it would not always impose FBAR penalties if the taxpayer could establish a "reasonable cause."[31] While this clarification was helpful, it provided little comfort to many with inadvertent violations, because establishing reasonable cause is sometimes difficult. For example, it is difficult to establish reasonable cause for failure to file an income tax return because the law assumes nearly every U.S. citizen knows about the obligation to file an income tax return.[32] By contrast, the FBAR filing requirement was relatively unknown until recently, but the IRS fact sheet does not explicitly make it easier for taxpayers to establish reasonable cause for failure to file an FBAR. For example, the taxpayer does not necessarily have reasonable cause if tax preparation software or a tax preparer failed to ask the taxpayer about foreign accounts.[33] The government expects the taxpayer to review the tax return that references FBAR reporting, expects this review to cause the taxpayer to file an FBAR, and may even assume that any failure to file an FBAR is thus due to willful blindness.[34] Even if a preparer affirmatively advised the taxpayer not to report a foreign account or the income from it, the taxpayer is likely to have difficulty getting the preparer to sign a statement acknowledging the inaccurate advice.[35] However, the IRS may require such a signed statement before it will make a reasonable cause determination. Thus, some people with inadvertent violations may not be able to establish reasonable cause.

The IRS recently established a process to allow nonresidents to make self-corrections outside of the OVD programs.

Under a new program, beginning September 1, 2012, nonresident nonfilers have the option of filing three years of delinquent returns (and six years of FBARs) without triggering penalties (the "Streamlined Nonresident Filing Initiative").[36] If each return reports less than $1,500 in additional tax due and the IRS deems them "simple," absent "high risk factors," the returns will be classified "low risk" and will not be examined. Participants are ineligible for the 2012 OVDP.

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31 IRS, FS-2011-13, *Information for U.S. Citizens or Dual Citizens Residing Outside the U.S.* (Dec. 2011), http://www.irs.gov/uac/Information-for-U.S.-Citizens-or-Dual-Citizens-Residing-Outside-the-U.S.

32 *See, e.g., United States v. Boyle*, 469 U.S. 241 (1985).

33 "Factors that might weigh in favor of a determination that an FBAR violation was due to reasonable cause include reliance upon the advice of a professional tax advisor **who was informed of the existence of the foreign financial account**, that the unreported account was established for a legitimate purpose and there were no indications of efforts taken to intentionally conceal the reporting of income or assets, and that there was no tax deficiency (or there was a tax deficiency but the amount was de minimis) related to the unreported foreign account." IRS, FS-2011-13, *Information for U.S. Citizens or Dual Citizens Residing Outside the U.S.* (Dec. 2011) [emphasis added]; Treas. Reg. § 1.6664-4 (reliance on tax advisor not reasonable if the taxpayer "fails to disclose a fact that it knows, or reasonably should know, to be relevant to the proper tax treatment of an item").

34 IRM 4.26.16.4.5.3 (July 1, 2008).

35 A benign actor with nothing to hide might have been less likely to question a preparer's advice or ask for a contemporaneous written opinion about the FBAR filing requirement.

36 IRS, *New Filing Compliance Procedures for Non-Resident U.S. Taxpayers* (first posted June 28, 2012), http://www.irs.gov/Individuals/International-Taxpayers/New-Filing-Compliance-Procedures-for-Non-Resident-U.S.-Taxpayers.

Because the IRS has provided little guidance about what makes a return "high risk," participants may still be subject to a full examination and potentially severe penalties, making the new program less attractive. Moreover, the IRS has not provided any similar self-service options for benign actors who are U.S. residents or owe more than $1,500.[37] The IRS should increase the threshold and allow U.S. residents to participate.[38] Nonetheless, this program is likely to reduce the burden on many nonresidents as well as on the IRS.

New duplicative reporting requirements make compliance more burdensome, and "stack" penalties.

Beginning in 2012, those with certain foreign financial assets in excess of $50,000 must report foreign account information (and certain other foreign financial asset information) on IRS Form 8938, *Statement of Specified Foreign Financial Assets*.[39] Form 8938 is sometimes called the "Tax FBAR" or "Super FBAR" because, as the Government Accountability Office (GAO) has observed, it duplicates much of the information required on the FBAR, though it is due with the return rather than on June 30, the due date for the FBAR.[40] In addition, a taxpayer who fails to report a single account on both forms could face two sets of penalties — the FBAR penalty under Title 31 and the Super FBAR penalty under Title 26.

Many benign actors still have not filed FBARs.

The IRS should be reducing (rather than increasing) the burden of correcting prior noncompliance and the burden of reporting foreign accounts in the future, given the existing compliance problem. While an estimated five to seven million U.S. citizens reside abroad and many U.S. residents also have FBAR filing requirements,[41] the IRS received only 741,249 FBAR filings in 2011.[42] In the face of what may be a serious FBAR compliance

37 For a description of some benign actors who are U.S. residents, see for example, Steve Mopsick, *Tax Justice II: No FBAR Penalties For Otherwise Compliant Recent Immigrants to the United States* (Aug. 2, 2012), http://mopsicktaxlaw.blogspot.com/2012/08/tax-justie-ii-no-fbar-penalties-for.html.

38 The National Taxpayer Advocate previously recommended increasing the $1,500 threshold to the "substantial understatement" threshold. National Taxpayer Advocate 2013 Objectives Report to Congress 24. Individuals who owe less than the greater of 10 percent of the tax required to be shown on the return or $ 5,000 may not have a "substantial understatement," and thus, may not be subject to an accuracy-related penalty, particularly if a negligence penalty does not apply. IRC § 6662(d). When the substantial understatement penalty applies due to an undisclosed foreign financial asset, the penalty rate increases from 20 to 40 percent. *See* IRC § 6662(j). Thus, there is precedent for using the combination of a substantial understatement and nondisclosure to distinguish minor omissions from those that may warrant more significant sanctions. Of course, we would still need to consider how to handle those who had not filed returns, as they would not have a substantial understatement.

39 IRC §§ 6038D and 1298(f); Notice 2011-55, 2011-29 I.R.B. 53 (July 18, 2011). An FBAR is due on June 30 if the aggregate value of the foreign accounts exceeded $10,000 during the prior calendar year. 31 C.F.R. § 1010.306(c).

40 GAO, GAO-12-403, *Reporting Foreign Accounts to the IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 2, 18 (Feb. 2012). Although the IRS met with GAO and provided technical information, neither the Financial Crimes Enforcement Network (FinCen) nor the IRS responded to GAO's recommendation to revise the Form 8938 and FBAR to address duplicative reporting. *Id*. at 3.

41 IRS website, *Reaching Out to Americans Abroad* (Apr. 2009), http://www.irs.gov/Businesses/Reaching-Out-to-Americans-Abroad; W&I Research Study Report, *Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors* (Feb. 2010) (citing U.S. Department of State data). This number does not include U.S. troops stationed abroad. Moreover, the tax gap associated with offshore accounts could be significant. *See, e.g.*, James Henry, Tax Justice Network, *The Price of Offshore Revisited* 5 (July 2012), http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf ("at least $21 to $32 trillion" may be "invested virtually tax-free through . . . more than 80 'offshore' secrecy jurisdictions").

42 IRS response to TAS information request (July 27, 2012).

problem, the government opened only 3,220 civil FBAR examinations and 18 criminal investigations in calendar year (CY) 2011.[43]

While the OVD programs attracted over 27,000 applications (perhaps less than one percent of those who did not file FBARs) and collected almost $5.5 billion, a more effective initiative could prompt significantly more taxpayers to come into compliance voluntarily.[44] The OVD programs may be prompting them to renounce U.S. citizenship instead. The number of people renouncing citizenship has risen to an all-time high — nearly quadrupling over a four-year period — from 470 in 2007 to 1,788 in 2011.[45]

The IRS stopped sending letters to educate those with foreign accounts about the foreign account reporting requirements.

IRS officials generated significant publicity about the FBAR reporting requirements by giving speeches and posting information to the IRS website.[46] Perhaps as a result, FBAR filings have more than doubled between 2008 and 2011 — from 349,667 in 2008 to 741,249 in 2011.[47] However, as noted above, this may still be only a fraction of the filings the IRS should receive.

In addition, the IRS has not conducted in-person presentations about the FBAR filing requirements in foreign countries, even in countries where it has a tax attaché and a significant number of residents are required to file.[48] This approach sends the message that the IRS will spend resources to punish, but not to educate, U.S. citizens abroad.

The IRS has also discontinued an FBAR Compliance Initiative Project to educate those with foreign bank accounts who are most likely to have FBAR violations.[49] While the Postal Service returned 22 percent of the project's letters as undeliverable, address research could help to reduce that problem.[50] In addition, the IRS has stopped work on an initiative to develop the FBAR Stop Filer Program.[51] The Stop Filer Program would send letters to

43 *Id.* This figure does not include OVD "certifications," but it does include "examinations" resulting from OVD submissions.

44 *Id.* (reporting the dollar amount); IRS response to TAS information request (Sept. 23, 2012) (reporting the number of applications).

45 The figures above reflect the number of names of expatriates published in the Federal Register.

46 IRS response to TAS information request (July 27, 2012). The IRS also recently reorganized materials on its website.

47 *Id.* For a graphic representation of the dramatic rise in Internet searches for the term "FBAR" after 2009, see http://www.google.com/trends/?q=FBAR (last visited, Sept. 21, 2012).

48 IRS response to TAS information request (Aug. 17, 2012). Nor does it plan to do so. IRS response to TAS information request (July 27, 2012). For additional discussion of this issue, *see* Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs, supra/infra*; National Taxpayer Advocate 2011 Annual Report to Congress 137-272 (Most Serious Problems: *Foreign Taxpayers Face Challenges in Fulfilling U.S. Tax Obligations*), 166-75 (Most Serious Problem: *Small Businesses Involved in International Economic Activity Need Targeted IRS Assistance*).

49 U.S. Department of the Treasury, *A Report to Congress in Accordance With § 361(B) of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* 5 (CY 2009) ("the project remains viable . . . [but] is currently closed."). Many foreign accounts are reflected in the Web-CBRS database. *Id.* at 5.

50 In response to 117 letters, 26 were returned as undeliverable, but the IRS received 73 responses and 15 FBAR filings. IRS response to TAS information request (Nov. 2, 2012). For suggestions to reduce undeliverable mail, see *Status Update: Underfunding of IRS Initiatives to Modernize Its Correspondence Systems Undermines Taxpayers' Statutory Rights and Impedes Efficient Resource Allocation, infra*.

51 IRS response to TAS information request (Aug. 8, 2012).

taxpayers who had filed an FBAR in the prior year, but not the current year, to remind them that they may still have a filing requirement. Thus, the IRS does not send letters to educate those for whom the requirements are the most relevant.

As information reporting on foreign accounts expands, a combination of targeted soft notices and expanded self-correction options could significantly improve voluntary compliance.

Over the next few years, foreign financial institutions will begin to report more foreign accounts to the IRS, enabling the IRS to identify many more FBAR violations.[52] New Form 8938 filings may also allow the IRS to identify more taxpayers who should have filed an FBAR.[53] Yet, the IRS is unlikely to have additional resources to address FBAR violations using enforcement tools or its OVD programs. As a result, it will increasingly have to ignore violations that it can detect unless it expands the self-correction options available to benign actors. If the IRS reinstated and expanded its soft notice programs and its Streamlined Nonresident Filing Initiative to encourage more benign actors to correct inadvertent violations without draining IRS resources, it could create a win-win situation — reducing the burden for them while freeing up IRS enforcement resources to address bad actors.

CONCLUSION

In conclusion, the National Taxpayer Advocate preliminarily recommends that the IRS:

1. Expand and clarify the Streamlined Nonresident Filing Initiative to encourage all benign actors (including U.S. residents and those owing more than $1,500) to correct past noncompliance using less burdensome procedures that do not unnecessarily drain IRS enforcement resources (*e.g.*, expand and clarify who qualifies for it and further explain who will be deemed to have reasonable cause for failure to file an FBAR).
2. Send "soft" notices to educate persons with foreign accounts about the FBAR and Form 8938 reporting requirements, encouraging them to self-correct inadvertent violations, as contemplated by the FBAR Compliance Initiative Project and the FBAR Stop Filer Program.
3. Clarify how beneficiaries of Canadian retirement plans can file late or amended returns that elect to exclude undistributed income from those plans by issuing formal guidance to consolidate the seemingly inconsistent guidance provided by Revenue Procedure 2002-23, 2002-1 C.B. 744 (requiring a PLR), IRM 21.5.3.4.9.1 (Aug. 4, 2009) (instructing employees to process late elections), and 2012 OVDP FAQ #54 (requiring a submission to an examiner) in a way that minimizes taxpayer burden.

52 Foreign financial intermediaries will soon be required to report more foreign accounts to the IRS. *See generally* IRC §§ 1471-1474; *Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities*, 77 Fed. Reg. ¶ 9022 (Feb. 15, 2012) (notice of proposed rulemaking).

53 *See* IRC §§ 6038D and 1298(f).

4. Revise Forms 8938 and/or TD F 90–22.1 to reduce taxpayer burden and the duplicative reporting identified by the GAO.[54]

IRS COMMENTS

Global tax enforcement is a top priority at the IRS, and we have made significant progress on multiple fronts, including groundbreaking international tax agreements and increased cooperation with other governments. In addition, the IRS and Justice Department have increased efforts involving criminal investigation of international tax evasion. This combination of efforts helped support the 2009 OVDP, the 2011 OVDI, and the ongoing 2012 OVDP. The goal of these programs is to get individuals back into the U.S. tax system and to turn the tide against offshore tax evasion. The programs have given U.S. taxpayers with undisclosed assets or income offshore an opportunity to get compliant with the U.S. tax system, pay their fair share, and avoid potential criminal charges. The programs have so far resulted in the collection of more than $5.5 billion in back taxes, interest, and penalties from approximately 38,000 applicants. In addition, the programs provided the IRS with a wealth of information on various banks and advisors assisting people with offshore tax evasion, which the IRS is using to continue its international enforcement efforts.

Throughout the programs, taxpayers have had the opportunity to opt out of the settlement structure and request an examination if the taxpayer disagrees with the result provided for under the program. The opt-out procedures and additional guidance issued on June 1, 2011, clarify that, depending on the facts and circumstances, it may be preferable for a particular taxpayer to opt out of one of the programs. In addition, the IRS added frequently asked questions to provide examples of circumstances in which taxpayers may want to consider opting out of the civil settlement structure and examples of when it might be a disadvantage to opt out. The IRS also advised employees working cases that taxpayers opting out should not be treated in a negative fashion merely because he or she opted out.

The IRS has taken a number of additional steps to assist taxpayers seeking to come into compliance. Last year, to address questions from international taxpayers, the IRS issued a fact sheet[55] to assist U.S. citizens and dual citizens residing outside the U.S. understand the federal tax return and FBAR filing requirements and return to compliance. More significantly, to address additional feedback from taxpayers and stakeholders, including practitioners and organizations representing taxpayers located overseas, the IRS provided a new option — the Streamlined Filing Compliance Procedures — effective September 1, 2012, to help some nonresident U.S. taxpayers who have not been filing tax returns come

54 The National Taxpayer Advocate previously recommended increasing the FBAR filing threshold to make it consistent with the Form 8938 filing threshold. *See* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 25 (noting the government could amend regulations under 31 C.F.R. § 1010.306(c) and/or change the FBAR form). She also recommended abating the penalty for the failure to file Form 8938 during the first year. *Id.* at 26. In addition, the IRS might reduce duplicative reporting by adding items reported on an FBAR to the existing list of items that taxpayers do not have to report on Form 8938. *See* Treas. Reg. § 1.6038D–7T.

55 http://www.irs.gov/uac/Information-for-U.S.-Citizens-or-Dual-Citizens-Residing-Outside-the-U.S.

into compliance. The option provides certain taxpayers who have resided outside of the U.S. since January 1, 2009, with a chance to catch up with their federal tax filing obligations if they owe little or no back taxes.

Situations of taxpayers with offshore compliance issues vary widely given the complexities of this area of tax law. While taxpayers should consult with their professional tax advisor to determine which option is the most appropriate given a taxpayer's specific facts and circumstance, the IRS did identify a number of common situations and potential solutions on IRS.gov to assist taxpayers.[56]

With regard to the recommendations in the report, the IRS notes the following.

As previously stated, in June 2012, the IRS announced new streamlined filing compliance procedures ("streamlined procedures"), effective September 1, 2012, for certain non-resident U.S. taxpayers who have failed to timely file U.S. federal income tax returns or FBARs but recently became aware of their filing obligations and now seek to come into compliance with the law. Under this program, taxpayers presenting low compliance risk will undergo an expedited review and the IRS will not assert penalties or pursue follow-up actions. In August 2012, the IRS issued streamlined procedural guidance, including submission instructions and a description of factors that, if present, suggest an increase in compliance risk level and therefore ineligibility for streamlined examination.[57] We will continue to evaluate the program and feedback received from taxpayers, practitioners, and other stakeholders to determine whether additional modifications to the program or guidance are necessary.

The IRS has taken a number of steps to educate persons with foreign accounts about the FBAR and Form 8938 reporting requirements. For example, the IRS created a comparison chart available on IRS.gov[58] to assist taxpayers in differentiating between FBAR and FATCA Form 8938 requirements. This chart has been publicized through several channels reaching U.S. filers located domestically and overseas, including the IRS Twitter account, communications by the IRS tax attachés located in U.S. consulates and embassies overseas with the assistance of the State Department, and the IRS National Public Liaison's practitioner email distribution list. The IRS will continue to share information with the public using IRS.gov and other communication vehicles to educate taxpayers regarding FBAR and FATCA filing requirements and will also continue to monitor whether additional outreach is appropriate.

In response to inquiries from taxpayers participating in one of the three voluntary disclosure programs with specified Canadian retirement plans, in June 2012, the IRS provided

56 http://www.irs.gov/Individuals/International-Taxpayers/Options-Available-to-Help-Taxpayers-With-Offshore-Interests.

57 http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers.

58 http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

instructions for how taxpayers could make the retroactive deferral of income elections.[59] In addition, the new Streamlined Procedures incorporated instructions for addressing this issue in its submission requirements.[60] We will continue to review other available guidance to determine if additional clarification is necessary.

With respect to the perceived duplicate reporting required on Forms 8938 and TD F 90-22.1, it is important to recognize that there are two separate reporting requirements under the law with different requirements. The FBAR (TD F 90-22.1) is required under Title 31 for law enforcement purposes in addition to tax administration. As a consequence, different policy considerations apply to FBAR and other information reporting, such as the Form 8938. These are reflected in the law defining differing categories of persons required to file Form 8938 and the FBAR, different filing thresholds for Form 8938 and FBAR reporting, and differing assets (and accompanying information) required to be reported on each form. These differing policy considerations were recognized during the passage of the HIRE Act and the enactment of section 6038D, and Congress's intention to retain FBAR reporting notwithstanding the enactment of section 6038D was specifically noted in the technical explanation of the revenue provisions contained in Senate amendment 3310, The "Hiring Incentives to Restore Employment Act," Under Consideration by the Senate (Staff of the Joint Comm. On Taxation, JCX-4-10 (February 23, 2010)) (Technical Explanation) accompanying the HIRE Act. The Technical Explanation states that "[n]othing in this provision [section 511 of the HIRE Act enacting section 6038D] is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision." (Technical Explanation at p. 60.) The IRS is committed to ensuring that taxpayers understand the different reporting requirements and will continue to explore whether further coordination of the requirements is possible provided the existing legal framework.

59 *See* 2012 OVDP FAQ 54 at http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers.

60 *See* instruction 7 at http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate fully supports the IRS's goal to design initiatives and offer settlements to "get individuals back into the U.S. tax system and to turn the tide against offshore tax evasion." Its new Streamlined Nonresident Filing Initiative is a significant step in the right direction. The National Taxpayer Advocate commends the IRS for addressing tax evasion and for its web-based efforts to educate taxpayers about little-known FBAR reporting requirements that, if overlooked, can trigger massive and disproportionate civil penalties.

However, the combination of the FBAR statute and the way the IRS administers it creates the potential for such draconian penalties that many taxpayers agree to pay unwarranted amounts to avoid the possible risk of being bankrupted several times over (as described below).[61] The IRS may believe that taxpayers have the choice to opt out of its OVD programs, but many do not feel that way.

Specifically, the FBAR statute authorizes a maximum penalty of up to 50 percent of the maximum balance in each overseas account for each year of non-reporting (or, if greater, $100,000 per violation).[62] Because the statute of limitations period is six years, the maximum penalty for large accounts is essentially 300 percent of the maximum account balances (assuming a relatively constant balance).[63]

> **Example:** Assume an individual with dual U.S.-Canadian citizenship who has lived his entire life in Canada has a $1 million account in a Canadian bank. To simplify, assume further that the balance has been $1 million for each of the past six years. Because this individual has violated the FBAR reporting requirements by failing to file Form TD F 90-22.1, the amount of the penalty could be as high as $3 million — three times his total savings! The penalty may be an even greater percentage of his savings if the account value has fallen since the end of the sixth year.

The National Taxpayer Advocate is concerned that such a disproportionate civil penalty amount, particularly in the absence of clear limits on the situations in which it can be applied, is excessive to the point of possibly violating the U.S. Constitution.[64] In any event, it is certainly a scary prospect for taxpayers.

61 Research suggests the IRS's current approach may be more likely to reduce voluntary compliance and increase tax evasion. *See e.g.*, TAS Research Study, *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, vol. 2, *infra* (finding a correlation between tax compliance and trust in government and the views of other members of local organizations toward the IRS and the U.S. tax system).

62 31 U.S.C. § 5321(a)(5)(C).

63 A six-year statute of limitations applies to the civil FBAR penalty. *See* 31 U.S.C. § 5321(b)(1). Criminal penalties of up to $500,000 and 10 years in prison may also apply. 31 U.S.C. §§ 5321(a)(5)(C) and 5322; 31 C.F.R. § 1010.840(b).

64 *See* Steven Toscher and Barbara Lubin, *When Penalties Are Excessive – The Excessive Fines Clause as a Limitation on the Imposition of the Willful FBAR Penalty*, J. Tax Prac. & Proc. 69-74 (Jan. 2010).

Far from allaying taxpayer concerns about this statute, the IRS OVD programs magnify them. In general, the OVD programs attempted to entice taxpayers to make voluntary disclosures by offering to cap the FBAR penalty and other penalties for failure to file information returns at 20 percent (or 25 or 27.5 percent for the 2011 and 2012 OVD programs, respectively) of the highest account value during the past six years (called the "offshore penalty"). For taxpayers who believe the IRS can prove they deliberately violated the disclosure statute, this is a good deal. But what about other taxpayers for whom penalties would be negligible?

The existing FBAR statute offers such taxpayers a better deal, capping the maximum penalty at $10,000 per violation if the IRS cannot prove the violation was willful and eliminating the penalty altogether if the taxpayer can show "reasonable cause" for his or her failure to report the account(s).[65] As discussed in prior reports, 2009 OVDP FAQ #35 provided seemingly clear assurances that "[u]nder no circumstances will a taxpayer be required to pay a penalty greater than what he would otherwise be liable for under existing statutes."[66] So if a taxpayer makes a voluntary disclosure under the 2009 OVDP and argues that his failure was nonwillful or due to reasonable cause, the IRS will consider that. Right?

Not really. The IRS now says that, notwithstanding FAQ #35, those who seek to pay a lower penalty must opt out of the OVD programs and submit to a full-blown examination.[67] That examination could yield a lesser penalty — but it also could yield a greater FBAR penalty, potentially the maximum.

A big disconnect exists between the way the IRS and taxpayers view the decision to opt out. From the IRS perspective, a taxpayer who believes his failure to report the account was nonwillful or subject to the reasonable cause exception can opt for an examination where he or she can demonstrate it. "If the taxpayer really has nothing to hide, why would the taxpayer hesitate?" the IRS reasons.

But that is not how many taxpayers react. Because of the IRS's aggressive statements and enforcement measures in the foreign bank account reporting area, many taxpayers start out scared to death about criminal prosecution and the possibility of losing 300 percent or more of the value of their accounts. Most are distrustful of the IRS and are not confident

65 31 U.S.C. § 5321(a)(5)(B).

66 National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29. *See also* Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011).

67 IRS guidance says it will consider accepting a lower penalty inside the 2009 OVDP if "discussions concerning the assertion of an offshore penalty lower than 20 percent have taken place with a TA, Territory Manager, Group Manager, Counsel, or member of the national team (*i.e.* during a case assistance visit) and the discussions **have been documented in the agents case file prior to Feb 8, 2011**." Memorandum from Director, SB/SE Examination, and Director, International Individual Compliance, for all OVDI Examiners, *Use of Discretion on 2009 OVDP Cases* (Mar. 1, 2011), http://www.irs.gov/pub/irs-drop/ovdi_memo_use_of_discretion_3-1-11.pdf. When the IRS does consider a lower penalty under FAQ #35, however, it reverses the burden of proof – requiring the taxpayer to prove nonwillfulness before considering the nonwillful penalty. Moreover, in TAS's view, even when a taxpayer proves nonwillfulness inside the 2009 OVDP, in some cases the IRS does not actually consider the facts they have presented. Rather, it asserts, without providing any explanation, that the taxpayer has not proved nonwillfulness and must opt out before the IRS will consider the facts.

it will be reasonable.[68] The fact that the IRS seemed to say through FAQ #35 that it would consider lesser penalties within the 2009 OVDP regime and is now backtracking increases taxpayer concerns about whether they will get a fair shake if they opt out.

TAS has encountered some examiners who, seeking to close OVD cases, suggested that the taxpayer would likely pay more if he or she opted out. Such statements are believable because the OVD examiner — the very same examiner who recommended against reducing the penalty within the OVD program — is required to make an *ex parte* recommendation to the opt-out committee about how to resolve the case if the taxpayer opts out.[69] Moreover, some taxpayers in this position come from countries with totalitarian regimes, where the government often enforces its laws in arbitrary ways. Thus, even where taxpayers feel strongly that their FBAR noncompliance was due to reasonable cause or was not willful, faced with the choice of accepting the IRS's proposed penalty (which, in our example, comes to $200,000 or 20 percent of $1 million) or opting for a full examination — with the hope of avoiding the penalty but with the knowledge that opting out could result in a potential penalty of far more than their net worth ($3 million in our example) — many will not want to risk opting out.

From a taxpayer's perspective, this may feel like extortion. In the opinion of the National Taxpayer Advocate, it is a significant intrusion on taxpayer rights.

More broadly, the National Taxpayer Advocate is concerned extreme penalties are sometimes enacted to combat extreme abuses, but the penalties inadvertently affect "benign actors" whose actions technically fall within the over-broad definition of the extreme conduct. In 2004, for example, Congress enacted IRC § 6707A, which imposed a strict liability penalty for failing to report participation in specified "listed transactions."[70] The penalty amount was $100,000 per individual per year and $200,000 per entity per year.[71] The penalty was intended to apply to those who engaged in egregious tax shelters. However, it soon became apparent that the penalties were affecting a range of small businesses, including some that created insurance programs to benefit their employees and did not know the transactions fit within the technical definition of a particular listed transaction. In some cases, individuals operated their businesses through wholly owned Subchapter S corporations, meaning that they were subject to penalties of $300,000 per year ($100,000 at the individual level and $200,000 at the entity level). After the National Taxpayer Advocate and

68 As the IRS's own characterization of these taxpayers in its response suggests, it starts with the misperception that it is giving people a great deal because it assumes it is giving people "an opportunity to get compliant with the U.S. tax system, pay their fair share, and avoid potential criminal charges." Most taxpayers who make inadvertent mistakes would not view the IRS offer as a good deal because they would not be subject to penalties at all. Rather, they would be alarmed by the implication that the IRS considers them potential targets of a criminal prosecution for inadvertently failing to file an information return. As discussed above, nobody who has opted out has been subject to criminal prosecution.

69 Memorandum for Commissioner, LB&I Division and Commissioner, SB/SE Division, from Deputy Commissioner for Services and Enforcement, *Guidance for Opt Out and Removal of Taxpayers from the Civil Settlement Structure of the 2009 OVDP and the 2011 OVDI* (June 1, 2011), http://www.irs.gov/pub/newsroom/2011_ovdi_opt_out_and_removal_guide_and_memo_june_1_2011.pdf.

70 American Jobs Creation Act, Pub. L. No. 108-357, § 811(a), 118 Stat. 1418 (2004); H.R. Rep. No. 108-548, pt. 1, at 261 (2004).

71 *See id.*

others raised concerns that the penalty was both disproportionate and applicable to a much wider swath of taxpayers than intended, Congress reduced the penalty.[72]

A similar situation arises here. The FBAR penalties generally are designed to apply to taxpayers who are intentionally evading U.S. tax by hiding significant untaxed assets in offshore accounts (the "bad actors"). But they are also affecting taxpayers with modest account balances and/or who did not intentionally evade tax, including those with assets in higher-tax jurisdictions where no tax evader would reasonably plan to hide assets. In administering this law, the IRS needs to do a better job of recognizing the distinction, and a key part of what is needed is to remove the fear of opting out of the OVD programs.

The National Taxpayer Advocate has suggested a three-category approach to improving the OVD programs to encourage voluntary compliance among those who failed to file FBARs and similar information returns. To encourage voluntary compliance, these taxpayers, who are coming forward before being contacted by the IRS, should be given reasonable options for correcting violations without having to opt out and risk disproportionate penalties.[73]

Category 1. Full relief from FBAR and information reporting penalties. Taxpayers whose underpayment is below a reasonable threshold amount — such as the IRC § 6662(d) threshold (*i.e.*, the greater of $5,000 or ten percent of the tax required to be shown) — should be permitted to file delinquent returns without penalty, regardless of whether they are residents.[74] They should not be subject to the threat of being deemed "high risk" and potentially hit with the maximum penalties, as is the case under the new Streamlined Nonresident Filing Initiative.[75]

Category 2. Taxpayers who have reasonable cause or who acted non-willfully. Taxpayers whose underpayment is greater than the threshold, but who believe they have reasonable cause or who acted non-willfully should provide an explanation of their circumstances, file delinquent returns, pay tax due, interest, accuracy-related penalties, and Title 26 information reporting penalties. Depending on the circumstances and explanation, these taxpayers should be required to pay either the non-willful FBAR penalty or no penalty under the

72 See National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, 24 (recommending legislation to make the penalty proportional to the decrease in tax, establish a "reasonable cause" exception, and to eliminate the potential for stacking); National Taxpayer Advocate 2008 Annual Report to Congress 419, 422 (same). Congress subsequently changed the law. See Creating Small Business Jobs Act of 2010, Pub. L. No. 111-240, Title II, § 2041(a), 124 Stat. 2506, 2560 (2010) (limiting the penalty to 75 percent of the decrease in tax shown on the return as a result of such transaction). For an analysis of continuing problems with the penalty, including the lack of a reasonable cause exception, see Toni Robinson and Mary Ferrari, *Congress Eases a Penalty, but Squanders Reform Opportunity*, 2011 Tax Notes Today 13-7 (Jan. 17, 2011).

73 See National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 23-25.

74 Under the 2009 OVDP FAQ #9, persons who failed to file FBARs and did not report all of their income are required to pay the offshore penalty, even if they have no tax liability. Under 2011 OVDI FAQ #18 and FAQ #19, those with no unreported tax liability for periods before 2011 were permitted to file corrected returns outside of the program without penalty. Under 2012 OVDP FAQ #18, those with no unreported tax liability are permitted to file corrected returns outside of the program without penalty.

75 Those who owe more than $1,500 per year or are U.S. residents are ineligible for the Streamlined Nonresident Filing Initiative. IRS, *Instructions for New Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers* (Aug. 31, 2012), http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers. Moreover, those deemed "high risk" may still be subject to a full examination and maximum penalties, even if they otherwise qualify. *Id*.

reasonable cause exception.[76] Because they are required to cooperate, the IRS should have little difficulty evaluating their circumstances without requiring them to opt out.

Category 3. Taxpayers not included in Category 1 or 2. Taxpayers who do not assert that their violations were nonwillful but still voluntarily come forward to correct them should be required to file delinquent or amended returns, and pay tax, interest, accuracy-related penalties, and the offshore penalty, as currently required under the OVD programs.

With regard to Category Two, in order to determine whether there are valid arguments to claim a reasonable cause exception, the facts and circumstances involving non-compliance would have to be carefully reviewed by practitioners. Anti-abuse rules could discourage Category Three taxpayers from self-selecting into Category Two. This reasonable three-category approach could prevent the IRS from being viewed as extorting unjustified penalties from innocent taxpayers and ultimately improve voluntary compliance. As the Internal Revenue Manual acknowledges,

> Examiners should consider whether the issuance of a warning letter and the securing of delinquent FBARS, rather than the assertion of a penalty, will achieve the desired result of improving compliance in the future... Discretion is necessary because the total amount of penalties that can be applied under the statute can greatly exceed an amount that would be appropriate in view of the violation.[77]

Having taken this important discretion away from OVD program examiners, IRS policymakers should consider how collecting the offshore penalty from benign actors who owe less under existing statutes might affect future compliance.

In addition, the IRS comments do not fully address the National Taxpayer Advocate's preliminary recommendations.

- The IRS has not stated whether it might implement the National Taxpayer Advocate's preliminary recommendation to expand the OVD programs and the Streamlined Nonresident Filing Initiative to prevent its procedures from collecting the proceeds of what many are likely to view as extortion.
- The IRS has not addressed whether it will send letters to people who have likely overlooked the information reporting requirements.

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

77 IRM 4.26.16.4(4)-(5) (July 1, 2008).

- The IRS does not dispute that it has provided and continues to provide beneficiaries of Canadian retirement plans with conflicting information about how they can file a late return that excludes undistributed income from the plan. As noted above, Revenue Procedure 2002-23, 2002-1 C.B. 744 (requiring a PLR), and IRM 21.5.3.4.9.1 (Aug. 4, 2009) (instructing employees to process late elections) both remain in force and conflict with 2012 OVDP FAQ #54 (requiring a submission to an examiner) and the instructions to the Streamlined Nonresident Filing Initiative. Yet, the IRS does not commit to combine or clarify this conflicting guidance.
- The IRS does not dispute that it is difficult for taxpayers to determine whether their violations are nonwillful or qualify for the reasonable cause exception, or that taxpayers cannot rely on statements on the IRS website. Yet, it does not commit to provide any clarifying guidance.

Finally, the IRS seems to justify its failure to minimize duplicative reporting that it is requiring on Forms 8938 and the FBAR (TD F 90-22.1), in part, on the basis of a Technical Explanation by Joint Committee on Taxation, which describes the new reporting requirement that Form 8938 seeks to implement. The IRS quotes a portion of the Technical Explanation, which states "[n]othing in this provision is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision." This language does not require FBAR reporting to remain unchanged, but simply explains that the legislation itself does not change the FBAR reporting requirements. Moreover, the Technical Explanation goes on to state that "regulatory exceptions to avoid duplicative reporting requirements are anticipated."[78] This seems to undercut any implication that Congress intended for Forms 8938 and TD F 90-22.1 to require duplicative reporting of the same information, as the GAO has identified. Further, a review of the entire Technical Explanation suggests that the reason the legislation did not eliminate FBAR reporting is because law enforcement components outside of the IRS, which do not have ready access to tax information, may need the information on an FBAR (TD F 90-22.1), which would not be possible if the information were instead collected on Form 8938 — a tax form subject to the confidentiality provisions of IRC § 6103. For its part, however, the IRS has access to FBAR (TD F 90-22.1) information. Thus, the Technical Explanation does not prevent the IRS from eliminating the requirement for taxpayers to report duplicative information on Form 8938. The National Taxpayer Advocate is encouraged that the IRS has committed to "explore whether further coordination of the [reporting] requirements is possible provided the existing legal framework."

78 JCT, JCX-4-10, *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, The "Hiring Incentives to Restore Employment Act," Under Consideration by the Senate* 60-61 (Feb. 23, 2010).

Recommendations

The National Taxpayer Advocate recommends the IRS take the following actions:

1. Adopt the three-category approach (described above), which does not require benign actors to opt out of the OVD program(s). Alternatively, the IRS could significantly expand and clarify the Streamlined Nonresident Filing Initiative to encourage all benign actors (including U.S. residents and those owing more than $1,500) to correct past noncompliance using less burdensome procedures (*e.g.*, expand and clarify who qualifies for it and further explain who will be deemed to have reasonable cause for failure to file an FBAR).
2. Send "soft" notices to educate persons with foreign accounts about the FBAR and Form 8938 reporting requirements, encouraging them to self-correct inadvertent violations, as contemplated by the FBAR Compliance Initiative Project and the FBAR Stop Filer Program.
3. Update Revenue Procedure 2002-23, 2002-1 C.B. 744 to clarify how beneficiaries of Canadian retirement plans can file late or amended returns that elect to exclude undistributed income from those plans.
4. Incorporate all OVD FAQs and the Streamlined Nonresident Filing Initiative (or the three-category approach, described above) into a Revenue Procedure (or similar guidance published in the Internal Revenue Bulletin) that incorporates comments from internal and external stakeholders.
5. Revise Forms 8938 and/or TD F 90–22.1 to reduce taxpayer burden and the duplicative reporting identified by the GAO.[79]

[79] The IRS might reduce duplicative reporting by adding items reported on an FBAR to the existing list of items that taxpayers do not have to report on Form 8938. *See* Treas. Reg. § 1.6038D–7T.

MSP #9

The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Deter Fraud

RESPONSIBLE OFFICIAL

Peggy Bogadi, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

Any individual who has a tax return filing obligation but is not eligible to obtain a Social Security number (SSN) must apply to the IRS for an Individual Taxpayer Identification Number (ITIN).[1] ITINs may also appear on credit histories and bank records to meet requirements of backup withholding and the Bank Secrecy Act.[2] For almost a decade, the National Taxpayer Advocate has raised concerns about ITIN policies and procedures, including the recurring bottlenecks of ITIN applications during the peak tax season and the associated strain on IRS resources, inhibiting an ability to timely detect and deter fraud.

Instead of conducting a comprehensive and strategic analysis of the problems associated with its ITIN program, the IRS has consistently adopted a reactive approach. Thus, on June 22, 2012, in response to a Treasury Inspector General for Tax Administration (TIGTA) report, the IRS abruptly announced interim changes to ITIN procedures, requiring applicants to submit only original documents or documents certified by the issuing agency, and suspending the certifying acceptance agent program.[3] This policy change exacerbated long-standing taxpayer service and compliance concerns present in ITIN operations, including:

- The unprecedented burden on ITIN applicants, imperiling their future tax compliance as well as their personal welfare and safety in the U.S. and abroad;
- The bottlenecks caused by seasonal processing of most ITIN applications, contributing to the proliferation of refundable credit schemes;
- The use of outdated processes in ITIN operations;
- The potential abrogation of the U.S. government's commitments under the 1961 Hague Apostille Convention;[4] and
- The lack of adequate oversight of the certifying acceptance agent program.

1 Internal Revenue Code (IRC) § 6109; Treas. Reg. § 301.6109-1(d)(3); Instructions to IRS Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Feb. 2012).

2 *See generally* Bank Secrecy Act, 31 U.S.C. §§ 5311-5314, 5316-5322; 12 U.S.C. § 1829(b); USA PATRIOT ACT, § 326, Pub. L. No. 107-56, 115 Stat. 307 (2001); 31 C.F.R. §§ 1010.410, 1010.620, 1022.400.

3 IR-2012-62 (June 22, 2012); TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* 29 (July 16, 2012).

4 The 1961 Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents (Hague Apostille Convention) (entered into force in the United States on Oct. 15, 1981), *available at* http://www.hcch.net/index_en.php?act=conventions.text&cid=41 (103 signatory countries) (last visited Dec. 20, 2012). *See* 33 U.S.T. 883, 527 U.N.T.S. 189, T.I.A.S. 10072, 94th Cong. 2d Sess. (1976) (with message and report, and text of Convention). *See also* Fed. R. Civ. P., Rule 44(a)(2) (notes).

ANALYSIS OF PROBLEM

Background

The IRS established the ITIN program in 1996 to facilitate tax return filing by individuals who have U.S. tax filing obligations and are ineligible for SSNs.[5] These individuals can fall into one of two categories:

- U.S. resident aliens taxable on their worldwide income; and
- Nonresidents taxable on certain U.S.-source income.[6]

Federal tax law determines a taxpayer's residency status for tax purposes, which may be different from the taxpayer's immigration status. For example, aliens for immigration purposes may be considered residents for tax purposes based on the number of days present in the U.S.[7] Nonresident alien spouses and dependents of U.S. citizens or residents must furnish ITINs to be able to file joint returns or be included on returns of primary taxpayers. Foreign students and researchers whose employment is not authorized by their immigration status also need ITINs to file returns or claim tax treaty benefits.

Although tax return filing is the most common use for ITINs, certain taxpayers are required to furnish ITINs for other legitimate tax administration purposes. For example, an ITIN may be used to report income associated with a bank account,[8] for information reporting,[9] or for withholding on the income of foreign investors.[10] An ITIN does not authorize an alien to work in the United States, grant an immigration status, or qualify the alien for the Earned Income Tax Credit (EITC) or Social Security benefits.[11]

Of 21 million ITINs assigned from the inception of the program in 1996 through August of processing year (PY) 2012, about 19.8 million (or about *94.4 percent*) showed up on tax returns or information returns (Forms W-2, 1099, W-4, W-8, W-9, 8288, 1042), as shown on Figure 1.9.1 below.[12] For example, between the inception of the ITIN program and February 2009, of all ITINs associated with returns, about 33 percent appeared as primary,

5 Certain persons are required to file U.S. income tax returns and pay U.S. income tax regardless of their immigration or residence status. *See* generally IRC §§ 7701, 864, 871; Treas. Reg. §§ 301.7701(b)-1; 864(c)(1)-(4). To be eligible for an SSN, a taxpayer generally must be a U.S. citizen, legal permanent resident (green card holder), or be in work-authorized immigration status. *See* U.S. Social Security Administration (SSA), ssa.gov (last visited Dec. 20, 2012). Examples of individuals who need ITINs include non-resident aliens filing a U.S. tax return and not eligible for an SSN, U.S. resident aliens (based on days present in the United States) filing a U.S. tax return and not eligible for an SSN, dependents or spouses of a U.S. citizen/resident alien; and dependents or spouses of non-resident alien visa holders.

6 *See* generally IRC § 7701. *See also* IRC §§ 1, 11, 61, 861, 862, 864, 871, 881, 882, and 1441-1446.

7 To become a resident for tax purposes, an individual must be present in the U.S. on at least 183 days during a three year period that includes the current year. *See* generally Treas. Reg. § 301.7701(b)–1(c).

8 *See* Form W-9, *Request for Taxpayer Identification Number and Certification*. *See also* Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY.

9 Forms W-2 and 1099 and its progeny (*e.g.*, 1099-DIV, 1099-INT, and 1099-OID).

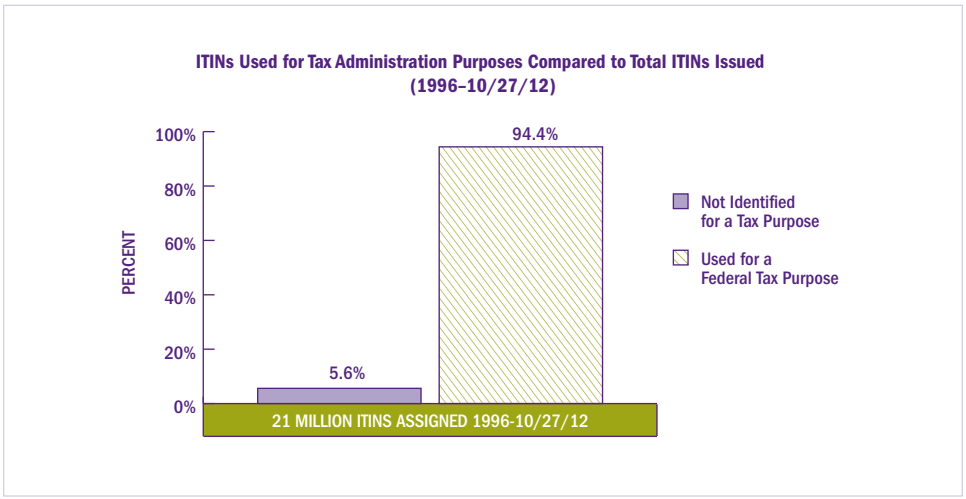
10 *See* generally IRC §§ 897, 1441-1445. *See also, e.g.*, Forms 8288, 1042, and 1042-S.

11 IRM 3.21.263.1(6) (Jan. 1, 2011).

12 IRS, *ITIN Production Reports* (Dec. 31, 2008 – Oct. 27, 2012); National Taxpayer Advocate 2008 Annual Report to Congress 127.

18 percent as secondary, and 40 percent as those of dependent taxpayers, with the remaining nine percent associated with information returns.[13]

FIGURE 1.9.1, ITINs Used for Tax Administration Purposes Compared to Total ITINs Issued from 1996 through October 27, 2012[14]

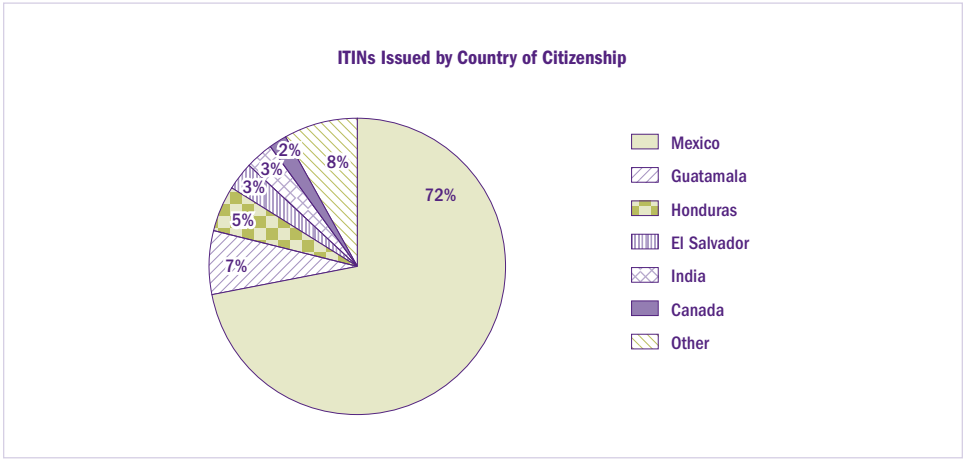


In PY 2012 (through August 2012), the IRS received about 90 percent of all ITIN applications from nationals of the following countries: Mexico (71.9 percent), Guatemala (7.1 percent), Honduras (4.7 percent), El Salvador (3.4 percent), and India (3.1 percent), as shown in Figure 1.9.2 below.

13 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File (IRTF), TYs 1996-2007, and Information Returns Master File (IRMF), TYs 2000-2006 (data drawn Feb. 2009).

14 Processing year means the year in which the ITIN application was assigned and is based on a calendar year. Taxable year generally means a calendar year for individuals.

FIGURE 1.9.2, All ITINs Issued by Country of Citizenship in PY 2012 (through August 2012)[15]



Dependents residing in Mexico (who account for 53.5 percent of all ITIN applications) can be claimed for the dependency exemption under the "contiguous country" exception.[16] Even though the child tax credit (CTC) and a refundable portion of this credit, known as the Additional CTC (ACTC), generally follow the dependency exemption rules, the IRC provides these credits only for children residing in the U.S.[17] The complexity and inconsistency among these requirements lead to widespread erroneous claims or omissions that cannot be attributable solely to fraud.[18] Requiring taxpayers to understand an exception (*i.e.*, CTC/ACTC) to an exception (*i.e.*, the contiguous country rule) to the general rule (*i.e.*, the dependency exemption) is a sure recipe for error.

In 2011, the last full processing year, the IRS assigned 1.7 million ITINs, of which approximately 270,000 went to non-resident aliens.[19] In PY 2011, an average ITIN filer received a

15 IRS response to TAS information request (Sept. 17, 2012).

16 An individual may generally deduct a dependency exemption amount for a child (or younger descendant or that of a sibling or step-sibling) under 19 (24 if a full-time student) sharing his or her home for over half the year who is a U.S. citizen or national, or a resident of the U.S., Canada, or Mexico. *See* IRC §§ 151(c), 152(b), (c). Different rules apply to dependents residing in Korea and India. *See* U.S.-Republic of Korea Income Tax Convention, Art. 4(7); U.S. - India Income Tax Convention, Art. 21(2).

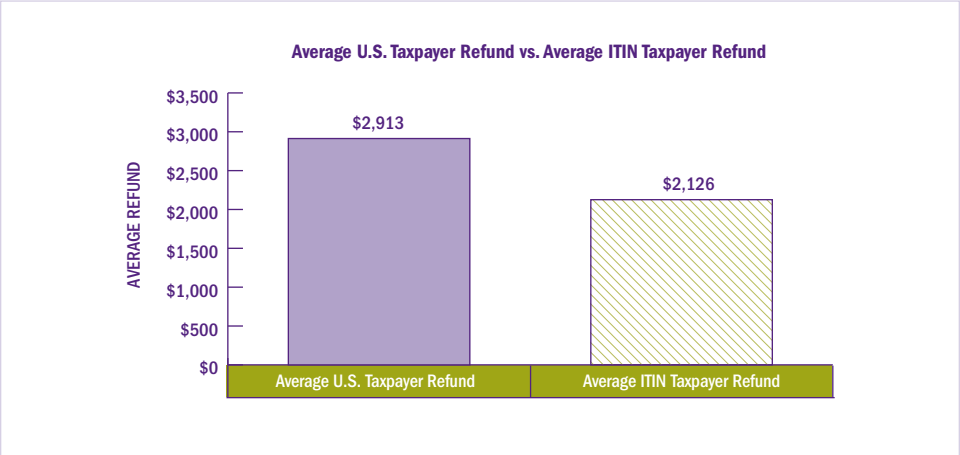
17 *See* IRC § 24(a), (c), and (d). With income below certain phase-outs, the primary taxpayer may claim a $1,000 CTC for a child under 17 who is a citizen, national, or resident of the U.S. for tax purposes. If the individual earns income below certain thresholds, ACTC in excess of tax owed is refundable. *See also* Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children, infra*.

18 Reports by the Treasury Inspector General for Tax Administration (TIGTA) have attracted headlines with the insinuation that the IRS paid billions of dollars in invalid and fraudulent ACTC claims, *i.e.*, those with ITINs rather than SSNs. *See* TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the ITIN Program to Detect Fraudulent Applications*, (July 16, 2012); TIGTA, Ref. No. 2009-40-057, *Actions Are Needed to Ensure Proper Use of ITINs and to Verify or Limit Refundable Credit Claims* (Mar. 31, 2009).

19 IRS, *ITIN Production Report* (Dec. 31, 2011). The IRS assigned 1,740,490 ITINs in 2011. Processing year is the calendar year in which ITIN applications were processed. TAS Research, CDW, IMF_TC150_HISTORY table (data drawn Aug. 27, 2012).

refund of $2,126 (including refundable credits) compared to an average of $2,913 for the general U.S. taxpayer population, as shown below.[20]

FIGURE 1.9.3, Average ITIN Refunds Are Smaller Than Average U.S. Taxpayer Refunds



In addition, employers withhold Social Security, Medicare, and unemployment taxes from ITIN taxpayers, who are generally ineligible for these benefits. The Social Security Administration (SSA) Earnings Suspense File (ESF) contains data regarding W-2 withholding that was not matched with a valid SSN. Tens of billions of dollars of employment taxes are annually withheld and paid by employers into the ESF on behalf of taxpayers ineligible for SSNs or with SSN mismatches.[21] In TY 2008 alone, SSA posted 9.4 million wage items, representing $86 billion, to the ESF.[22]

The IRS's Policy Change to Require Applicants to Submit Only Original Documents or Documents Certified by the Issuing Agency Imposes an Onerous Burden on Taxpayers and May Irreversibly Harm Compliance and Endanger Taxpayers.

On June 22, 2012, the IRS abruptly and unilaterally changed ITIN application procedures without discussing these changes with internal and external stakeholders.[23] The IRS eliminated the option of providing a notarized copy of required identification documents, such as passports and birth certificates, with the Form W-7, *Application for IRS Individual Tax Identification Number*. Individuals applying for an ITIN must now either mail their

20 *Cf.* TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* 29 (July 16, 2012) and IRS, Filing Season Statistics – Dec. 31, 2011, *available at* http://www.irs.gov/uac/Filing-Season-Statistics----Dec.-31,-2011 (last visited Sept. 2, 2012).

21 *See* SSA Performance and Accountability Reports (PAR), fiscal years (FYs) 2006-2011. As of October 2010, the ESF had accumulated approximately 305 million wage items and about $921 billion in wages for TYs 1937-2008. SSA FY 2011 PAR, at 176.

22 SSA FY 2010 PAR, at 176. From TY 2000 to TY 2008, the ESF grew from 3.8 percent of total reported wage items to 4.3 percent of all wages. SSA FY 2010 PAR, at 178.

23 IR-2012-62 (June 22, 2012). The IRS announced that the procedures were in effect through the end of TY 2012. Although the IRS notified the National Taxpayer Advocate that it would be changing its ITIN procedures, it did not share with her the actual interim procedures prior to publication.

original passports or other acceptable government-issued identification documents (or certified copies of these documents obtained from the original issuing agency) to the IRS Austin Service Center with their Forms W-7. The IRS indicated that it might take *60 days or longer* to return these original documents to the applicant via standard U.S. mail.[24] The IRS did not authorize its walk-in sites to verify original documentation presented by ITIN applicants but instead instructed the sites to forward the original documentation to the centralized processing unit in Austin.

The IRS also immediately stopped issuing ITINs for applications submitted through certifying acceptance agents (CAAs) unless they include original documentation or copies of original documents certified by the issuing agency. Prior to this change, ITIN applicants using CAAs could present their original documents to the CAA for verification without having to submit notarized copies to the IRS.[25]

These changes imposed a significant burden on ITIN applicants. Numerous stakeholders, including Low-Income Taxpayer Clinics (LITCs), colleges and universities, Volunteer Income Tax Assistance (VITA) sites, and tax practitioners complained about the extreme and unnecessary burden of these new interim procedures on taxpayers, and the harm to future compliance and the U.S. economy. Some commented that the policy has such a chilling effect on compliance that the affected taxpayers may stop filing returns altogether.[26] One LITC that conducts English as a Second Language (ESL) outreach for low income taxpayers complained that it had to cancel a scheduled workshop in September 2012 for ITIN applicants because no one appeared.[27] The clinic believes the applicants are not coming because they are reluctant to give up original identification documents. As the chart below shows, the number of ITIN applications significantly decreased in the months following the June 22, 2012 policy change compared to the same period in PY 2011.[28] At the same time, the number of rejected applications significantly increased.

24 IRS, *2012 ITIN Review Frequently Asked Questions, available at* http://www.irs.gov/uac/2012-ITIN-Review-Frequently-Asked-Questions-1 (last visited Nov. 2, 2012).

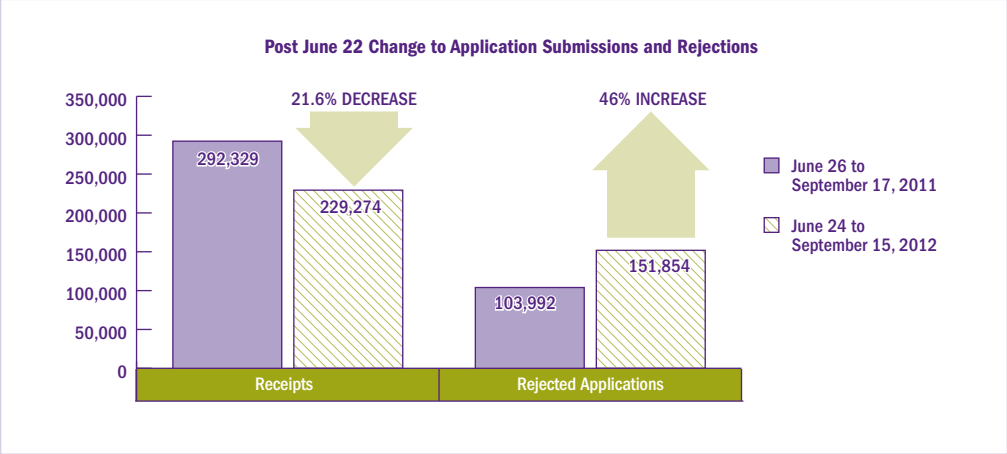
25 *See* Rev. Proc. 2006-10, 2006-1 C.B. 293.

26 TAS Teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug. 30, 2012); ABA Section of Litigation, Immigration Litigation Committee (Aug. 30, 2012); Low Income Taxpayer Clinics (Aug. 27, 2012); National Community Tax Coalition (Aug. 23, 2012).

27 National Taxpayer Advocate and IRS teleconference with LITCs (Sept. 27, 2012).

28 IRS, Real-Time System (RTS) reports (Sept. 22, 2012). The decline in ITIN receipts before June 22, 2012 constitutes 0.6 percent compared to the same period of TY 2011, while the decline in ITIN receipts after June 22 is 21.6 percent.

FIGURE 1.9.4, Received and Rejected ITIN Applications in Second Quarters of Processing Years 2011 and 2012



The IRS's Policy Change Harmed Foreign Taxpayers.

The requirement to provide original documents or copies certified by the issuing agency imposed a significant burden on many groups of taxpayers, including foreign students and businesspeople:

- **Foreign students[29]:** Hundreds of thousands of foreign students bring more than $20 billion into the U.S. economy every year.[30] In FY 2011, the United States granted about 850,000 visas in student visa categories.[31] As of April 2, 2012, there were about 1.2 million students, exchange visitors, and their dependents in active visa status.[32] All these students are in the country legally under the Student and Exchange Visitor Program (SEVP).[33] The Department of Homeland Security (DHS) has authorized Designated School Officials (DSOs) of the 9,888 SEVP-member schools and Responsible Officers (ROs) of the 1,426 exchange visitor program sponsors to verify students' or visitors' documentation and certify extensions of visas on Forms I-20 and DS-2019.[34]
- **Foreign businesspeople and investors:** Foreign individuals who have a U.S. filing obligation need ITINs to file a return, to make an election, claim an exemption from withholding, or submit a form to a partnership or a corporation that conducts business

29 *See e.g.*, Community Colleges for International Development, Inc. letter to the National Taxpayer Advocate (July 23, 2012).

30 USA Today, *More foreign students studying in USA*, Nov.14, 2011, *available at* http://www.usatoday.com/news/education/story/2011-11-13/foreign-students-boost-usa-economy/51188560/1 (last visited on Sept. 19, 2012). While some of these taxpayers who are authorized to work in the United States are eligible for an SSN, many others have taxable income and need an ITIN to comply with their U.S. tax filing requirements.

31 U.S. Dept. of State, Nonimmigrant Visas Issued FY 2011.

32 U.S. Dept. of Homeland Security, The Student and Exchange Visitor Program (SEVP) Quarterly Review (Apr. 2, 2012). Since the inception of the program in 2003, the number of visa holders increased to approximately 9.5 million.

33 SEVIS, http://www.ice.gov/sevis/. This web-based system collects real-time information on nonimmigrant students, exchange visitors, approved schools, and program sponsors.

34 U.S. Dept. of Homeland Security, The Student and Exchange Visitor Program (SEVP) Quarterly Review (Apr. 2, 2012).

in the United States. These taxpayers are considered nonresidents for tax purposes and generally cannot claim exemptions or refundable credits.[35] While the IRS has no reliable estimate of the number of nonresident alien taxpayers who may have filing obligations, it receives between 600,000 and 700,000 returns from these taxpayers each year.[36]

The IRS's policy change created a tremendous burden on these taxpayers, including:

- The extended time (from one to three months, not including the IRS processing time of at least 60 days) without a passport. For students, this limited their ability to timely leave the country after the authorized period of stay or to travel in emergencies. For businesspeople, this can cause substantial damage to their business activities, preventing travel until the IRS returns their passports.
- The inability to submit documents certified by an apostille, which violates the U.S. government's obligations under the Hague Convention.[37]
- Violation of prohibitions against sending original passports by mail in certain countries.[38]
- The inability to obtain a certified copy from certain country embassies or a copy of a U.S. visa certified by the Department of State.[39]
- The extended period of time (often many months) and associated costs required to obtain a duplicate, if the passport is lost.
- The inability to apply for required driver's licenses for taxpayers who are considered temporary state residents.[40]

35 For a taxpayer to be considered a U.S. resident for tax purposes, he or she must meet either the green card or the substantial presence test for the calendar year. Under the substantial presence test, a taxpayer should be physically present in the United States on at least 31 days during the current year, and 183 days during the past three years, calculated according to a special formula. For a detailed discussion of the contiguous country rule for dependency exemptions, see Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children, infra*.

36 IRS Office of Research, Forecasting and Statistics, Document 6187 (Sept. 2010 and July 2012), Tables 1B. *See also* National Taxpayer Advocate 2011 Annual Report to Congress 137-150.

37 As a signatory to the Hague Convention, the United States agreed to recognize public (including notarized) documents issued by other signatory countries if those public documents are authenticated by the attachment of an internationally recognized form of authentication known as an apostille. *See* Hague Apostille Convention, *available at* http://www.hcch.net/index_en.php?act=conventions.text&cid=41 (103 signatory countries) (last visited Dec. 20, 2012).

38 For example, Algeria, India, Lithuania, Russia, Tunisia, and Ukraine prohibit mailing passports across borders. *See, e.g.*, Indian Embassy in the United States, *available at* http://www.indianembassy.org/index.php?option=com_faqs&task=detail&id=2 (last visited Dec. 20, 2012); FedEx web site, *available at* http://www.fedex.com/ru_english/shippingguide/exportguidelines/ (last visited Dec. 20, 2012); United States Postal Service (USPS), *available at* http://pe.usps.com/text/imm/tz_016.htm (last visited Dec. 20, 2012). Interestingly, the U.S. consulate in Nogales, Mexico does not permit the mailing of documents of citizenship, see U.S. Consulate in Nogales, Mexico, *available at* http://spanish.nogales.usconsulate.gov/non_em_svcs2.html ("El Consulado Estadounidense en Nogales, Sonora no permite el envío/recibo por correo de documentos de Ciudadanía.") (last visited Sept. 25, 2012).

39 AICPA Comments Regarding the Internal Revenue Service's (IRS's or Service's) June 22, 2012 Interim Policy Changes Involving the Individual Taxpayer Identification Number (ITIN) Application Process to the National Taxpayer Advocate (Oct. 16, 2012); TAS and IRS teleconferences with U.S. college and university representatives (Aug. 23, 2012 and Sept. 13, 2012).

40 Community Colleges for International Development, Inc. letter to the National Taxpayer Advocate (July 23, 2012); TAS and IRS teleconferences with U.S. college and university representatives (Aug. 23, 2012 and Sept. 13, 2012); National Taxpayer Advocate email to the Deputy IRS Commissioner for Services and Enforcement (July 25, 2012).

The policy change may also prevent foreign businesspeople or investors from filing for an election or to apply for a withholding certificate under the Foreign Investment in Real Property Tax Act (FIRPTA).[41] As a result, the IRS may be preventing or discouraging foreign investment into the U.S. economy.[42] The following example provided to TAS by a practitioner describes the harm the new ITIN rules created:

> **EXAMPLE:** Two potential investors in real estate in Florida, which is trying to attract foreign investments in foreclosed real estate, are no longer interested in applying for ITINs and have abandoned the idea of investing in the U.S. One investor was a Canadian who just got a notarized copy of his identification documents. The other investor, who is from India, travels the world for business, but under Indian law cannot mail his passport. If he sent it to the IRS, he could not travel. His passport is actually nine passports stapled together, containing over 500 pages with visas from 50 countries. In India, he would have to wait six months to get new passports. Thus, because of the new IRS policy, the businessman chose not to invest in the U.S.[43]

The Policy Change Imposed Onerous Burdens on Individual Taxpayers in the United States and Their Dependents Abroad.

Outside stakeholders, LITCs and TAS case advocates have reported the policy change will cause foreign individuals who are U.S. residents for tax purposes to experience the following burdens, which may irreversibly harm them and their filing compliance:[44]

- Taxpayers in several states risk being detained for an extended time (for example, incident to a routine traffic stop) for not having identification documents that they sent to the IRS.[45] As a result, some taxpayers, whether in the U.S. legally or not, who may feel threatened by the "show me your papers" laws, could choose a path of least resistance and decide not to file taxes at all, costing the government reductions in voluntary compliance and tax revenue.[46]

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41 *See, e.g.*, IRC § 83(b); Treas. Reg. § 1.83-2(e)(1) (a taxpayer identifying number (TIN) is required to make an election to treat the receipt of stock as income when received; the election must be made within 30 days of the transfer of property; no extensions are permitted); IRC § 7701(b); Treas. Reg. § 301.7701-3 (to obtain an EIN for a foreign entity in order to make an entity classification election, its principal officer must have a TIN); IRC § 1445 (a TIN is required on Form 8288-B, *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*).

42 *See, e.g.*, Systemic Advocacy Management System (SAMS) submissions No. 25328, 25401, and 24891; TAS Teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug.30, 2012); ABA Section of Litigation, Immigration Litigation Committee (Aug. 30, 2012); AICPA letter to the IRS Commissioner (Aug. 28, 2012).

43 SAMS Issue No. 24891 (July 6, 2012) (Consent for Disclosure of Tax Information is on file with the National Taxpayer Advocate).

44 AICPA letter to the IRS Commissioner (Aug. 28, 2012); National Community Tax Coalition (NCTC) letter to the IRS Commissioner (Aug. 20, 2012).

45 *See* Ariz. Rev. Stat. Ann. § 11–1051(B) (passed as a part of Arizona S.B. 1070 law); *Arizona v. U.S.*, 132 S.Ct. 2492 (2012) (officer conducting stop, detention, or arrest can verify individual's immigration status with federal government if officer had suspicion that the person was unlawfully in the U.S.). Similar statutes were passed in Georgia, Alabama, Indiana, South Carolina, and Utah. The New York Times, *Arizona Immigration Law* (SB 1070) (June 25, 2012), *available at* http://topics.nytimes.com/top/reference/timestopics/subjects/i/immigration-and-emigration/arizona-immigration-law-sb-1070/index.html (last visited Dec. 20, 2012).

46 SAMS Issue No. 25007 (July 9, 2012). *See also* AICPA letter to the IRS Commissioner (Aug. 28, 2012); National Community Tax Coalition (NCTC) letter to the IRS Commissioner (Aug. 20, 2012) (NCTC is a membership coalition of community-based organizations offering free tax and financial services to low- and moderate-income, working families through Volunteer Income Tax Assistance (VITA) programs).

- Some countries require citizens to carry identification documents at all times. The IRS's interim rule puts taxpayers' spouses and dependents who are not even present in the U.S. at risk of detention in those countries.[47]
- Depending upon the taxpayer's location in the U.S., it may not be possible or practical to appear in person at the consular office.
- Some prospective ITIN applicants have been advised by their home countries' consulates that they do not issue certified copies of passports.[48]
- Some countries, e.g., the United Kingdom and the Commonwealth countries, will not issue a certified copy of a passport at all — even if the applicant is present in the home country. The only way to have the government stamp a copy is via the apostille process.[49]
- Some countries do not provide any type of certification process for these documents, making it impossible for taxpayers to secure an ITIN.[50]
- In order to file timely returns, some taxpayers must forego a joint return and any exemptions because their spouses and dependents cannot obtain ITINs before the return filing date. As a result, they could be made to pay more in taxes than they legally owe.[51]
- Some unbanked taxpayers, many of whom are low income, cannot cash checks until their original documents are returned.[52]
- Taxpayers who are low income and therefore transient are at greater risk of losing their documents in the mail or at the IRS, and of becoming victims of identity theft and associated fraud.

Original Documents are Often Lost, Imposing Significant Hardship on Applicants.

TAS case advocates and LITCs note that the original documents sent by regular mail to applicants are often lost.[53] The IRS normally returns originals by regular mail within 60 days

47 For example, all Belgians from the age of fifteen are required to carry electronic identity cards at all times. *See Electronic Identity Documents*, Belgian Official eID web site, *available at* http://eid.belgium.be/en/find_out_more_about_the_eid/the_electronic_identity_documents/ (last visited Oct. 20, 2012). In Turkey, locals have compulsory ID cards, which they must carry with them at all times. *See* Turkey's Official Travel Portal, *available at* http://www.goturkey.com/content.php?cid=51533&typ=c&lng=en (last visited Oct. 20, 2012).

48 AICPA letter to the National Taxpayer Advocate (Oct. 16, 2012).

49 TAS teleconferences with LITCs (Aug. 27, 2012); TAS Teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug.30, 2012); National Community Tax Coalition (Aug. 23, 2012); TAS attorney advisor and Systemic Advocacy analyst meeting with case advocates at Austin campus (Sept. 19, 2012); TAS call to the Embassy of Ukraine in Washington, D.C. (Sept. 27, 2012). For a detailed discussion of the apostille certification process, see Hague Apostille Convention *available at* http://www.hcch.net (last visited Dec. 20, 2012).

50 TAS teleconferences with Low Income Taxpayer Clinics (Aug. 27, 2012); TAS teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug. 30, 2012); NCTC (Aug. 23, 2012); TAS attorney advisor and Systemic Advocacy analyst meeting with case advocates at Austin campus (Sept. 19, 2012).

51 *E.g.*, a TIN is required to claim a Child Tax Credit (CTC) or a dependency exemption. IRC §§ 24(e); 151(e). If a return is filed without a TIN, the IRS may disallow credits and exemptions and assess any resulting deficiency under procedures for mathematical or clerical errors. IRC § 6213(g)(2).

52 National Taxpayer Advocate and IRS teleconference with LITCs (Sept. 27, 2012).

53 Teleconferences with TAS case advocates (Aug. 24, 2012); LITCs (Aug. 27, 2012).

of receipt.[54] If these documents are returned to the IRS as undeliverable, IRS procedures do not require a personal contact with the taxpayer over the phone.[55] Instead, if the IRS does not detect a better address, it mails the original passports to embassies of issuing countries and destroys other items.[56] Many ITIN applicants are low income and transient.[57] However, given the high percentage of cell phone usage in this country, most applicants probably do have a contact phone number that they retain for a long time.[58] The IRS should change the Internal Revenue Manual (IRM) to require ITIN employees to contact the applicant if a document is returned as undeliverable. The IRS should also send the original documents by trackable mail service, such as certified, registered, or priority mail, and allow applicants who need their documents back more quickly the option of including a prepaid Express Mail or Courier envelope.[59] In addition, we recommend the IRS revise its Form W-7 to allow applicants to provide contact information of a third party designee for limited purposes of discussing Form W-7 processing issues with the designated third party, similar to a third party designee box on a tax return.[60]

The IRS Should Have Focused Specifically on Refund Schemes Instead of Establishing Prohibitive Requirements for the Entire ITIN Population.

The IRS changed its procedures in response to a recent TIGTA report that identified certain tax refund fraud connected to refundable credits and exemptions.[61] However, it is unclear how receipt of an original passport or other identification provides the IRS with any more certainty that the applicant is actually the owner of the document or shows that the applicant is eligible for any refundable credits claimed. For example, for the taxpayer to claim a CTC or Additional CTC, his or her child must satisfy certain requirements not substantiated by the claimant's documents.[62]

Generally, to claim exemptions for spouses and dependents, the ITIN taxpayer must be a U.S. resident alien for tax purposes, a resident of Canada or Mexico, or a resident of India

54 IRM 3.21.263.5.2.10 (Jan. 1, 2011).

55 Over 19 million pieces of mail each year, or ten percent of all correspondence the IRS sends to taxpayers, are returned as "undeliverable as addressed." The documents may also be lost within the IRS. For a more detailed discussion, see Status Update: *Underfunding IRS Initiatives to Modernize its Taxpayer Address Correspondence Systems Undermines Taxpayers' Statutory Rights and Impedes Efficient Resource Allocation, infra*.

56 SERP IRM 3.21.263.5.2.11 (5) (June 27, 2012) and IRM 3.21.263.5.10.4 (11) and (12) (Sept. 24, 2012).

57 Randy Capps *et al.*, *A Profile of Low-Income Working Immigrant Families* 2, The Urban Institute (June 2005), http://www.urban.org/UploadedPDF/311206_B-67.pdf (last visited Nov. 2, 2012). *See also* American College of Emergency Physicians, *Illegal Immigrant Care in the Emergency Department*, http://www.acep.org/content.aspx?id=25206 (last visited Nov. 2, 2012).

58 About 92 percent of all adults in the United States have a cell phone. Forrester Research, Inc., North American Technographics Online Benchmark Survey (Part 2), Q3 2012. However, the lack of paid minutes for some low income taxpayers may limit reliability of cell phone access.

59 *See* National Taxpayer Advocate 2010 Annual Report to Congress 221-234 (Most Serious Problem: *The IRS has not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

60 *See* Form 1040, U.S. Individual Tax Return (2011) which contains a third party designee box on page 2 of the return. It allows a preparer, a friend, a family member, or any other person to discuss tax return with the IRS over the phone and answer any questions that may arise during processing. The designee may also provide the IRS any information missing from the return, call the IRS for information about the processing of the return or the status of any refund or payment, receive copies of IRS notices and provide responses to such notices. *See* Form 1040 Instructions (2011), at 72.

61 TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 2012). The report identified erroneous Child Tax Credit refunds and thousands of returns filed from a few addresses.

62 *See* generally IRC §§ 24 and 151.

or the Republic of Korea meeting certain requirements.[63] While the IRS may have a legitimate reason to scrutinize ITIN applications from nationals of these countries, it does not have justification for imposing undue burden on all ITIN applicants.[64] Its one-size-fits-all approach to documents does not resolve concerns about dependency exemptions and the CTC and harms generally compliant taxpayer groups.

Seasonal Processing of Most ITIN Applications and the Absence of Revocation Procedures Exacerbates the IRS's Inability to Timely Detect and Deter Fraud.

For several years, the National Taxpayer Advocate has criticized the IRS policy of processing ITIN applications only with paper tax returns during the filing season, on the grounds that it creates seasonal bottlenecks affecting over one million tax returns and associated refunds annually.[65] The policy is in response to the fear that the bulk of ITIN applications are submitted by resident aliens employed in the U.S. illegally who seek ITINs for non-tax purposes, such as for obtaining a driver's license.[66] However, as discussed above, over 94.4 percent of issued ITINs appear on tax returns.[67] In addition, most states do not require an applicant for a driver's license or a state ID card to provide an SSN, removing an incentive for ITIN holders to use ITINs for non-tax purposes.[68]

The requirement that ITIN applications be submitted along with tax returns strains IRS resources during the filing season, condensing a 12-month ITIN workload into four months. This process does not allocate sufficient time or resources to verify the existence of wage income or the tax filing need for those claiming exemptions and credits.

Allowing taxpayers to obtain ITINs throughout the year would enable the IRS to build in additional time for analyzing trends and verifying wage and withholding amounts before

63 *See* generally IRC §§ 152(b)(3)(A); 873(b)(3). *See also* U.S. – Republic of Korea Tax Convention, Art. 4(7) and U.S. – India Tax Convention, Art. 21(2). These restrictions do not apply if the ITIN applicant is a nonresident alien married to a U. S. citizen or resident alien and has chosen to be treated as a resident of the United States. For a more detailed discussion of the contiguous country rule for dependency exemptions, see Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children*, *infra*.

64 In PY 2012 (through August 2012), the IRS received about 90 percent of all ITIN applications from the nationals of the following countries: Mexico – 71.9 percent; Guatemala – 7.1 percent; Honduras – 4.7 percent; El Salvador – 3.4 percent; and India – 3.1 percent. IRS response to TAS information request (Sept. 17, 2012).

65 *See, e.g.*, National Taxpayer Advocate 2010 Annual Report to Congress 319-34 (Status Update: *Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers*), National Taxpayer Advocate 2009 Annual Report to Congress 520-22; National Taxpayer Advocate 2008 Annual Report to Congress 126-40 (Most Serious Problem: *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*); Taxpayer Advocate Directive (TAD) 2009-1 (Processing of Forms W-7/Filing of ITIN Applications and Associated Tax Returns) (Feb. 25, 2009).

66 National Taxpayer Advocate 2010 Annual Report to Congress 327-28. *See also* Government Accountability Office (GAO), Ref. No. GAO-04-529T, *Individual Taxpayer Identification Numbers Can Be Improperly Obtained and Used* (Mar. 10, 2004); TIGTA, Ref. No. 2004-30-023, *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Jan. 2004).

67 *See* Figure 1.9.1, ITINs Used for Tax Administration Purposes Compared to Total ITINs Issued From 1996 Through August 31, 2012, *supra*.

68 U.S. Immigration and Customs Enforcement, Factsheet, *Applying for a Driver's License or State Identification Card* (Jan. 17, 2012). In most states, however, the nonimmigrant alien needs to apply for an SSN and present a Form SSA-L676, *Refusal to Process SSN Application*, when applying at the Department of Motor Vehicles.

the filing season begins.[69] To reduce the improper use of ITINs, the IRS should develop a process to revoke the numbers that are no longer used for tax purposes, after notifying the taxpayer; for example, in situations when the taxpayer leaves the country (as would a student) or receives an SSN.

The IRS Should Apply Existing Processes to Timely Identify and Prevent Potential Fraud Schemes Involving ITIN Applicants.

Unlike the Questionable Refund Program (QRP) and its successor, the Accounts Management Taxpayer Assurance Program (AMTAP), the ITIN program was not designed to select and examine returns suspected of fraud. The ITIN program does not have electronic applications or filters to screen, score, and select returns for review.[70] The inability of the ITIN operation to screen returns is exacerbated by the IRS's insistence on processing the bulk of ITIN applications attached to paper returns during the peak filing season as discussed above. Thus, efforts to detect fraud when processing ITIN applications are necessarily unwieldy, ineffective, and subjective. If ITINs were assigned before the filing season, the returns associated with them would be subject to all fraud detection filters the IRS uses for all other returns claiming refunds. As further illustration of the ITIN program's deficiencies, the IRS has identified multiple fraud schemes, *e.g.*, thousands of returns filed from the same address, same return information, same CAA, etc. [71] However, it failed to take timely enforcement actions against perpetrators. Yet these returns have precisely the kind of characteristics that the IRS's regular return processing routinely catches and stops.

The IRS also misses the opportunity to use the recently adopted Preparer Tax Identification Number (PTIN) regulations to address potential ITIN-related fraud by tax preparers.[72] If it requires preparers to provide a PTIN on an ITIN application (Form W-7) the IRS will be able to link questionable or potentially fraudulent applications to a preparer and take appropriate action, including a referral to the IRS Criminal Investigation (CI) division, the Return Preparer Office, or the Office of Professional Responsibility, and a referral to the U.S. Department of Justice for a court injunction against the preparer.[73]

69 Acting on TAS's recommendation, the IRS now accepts pay stubs, letters from the employer on the employer's letterhead, earnings statements, and other corroborating documents such as employee benefits forms as a proof of wage income and tax filing need. *See* IRM 4.19.15.38.4 (Sept. 6, 2012). *See also* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 54.

70 AMTAP uses the Electronic Fraud Detection System (EFDS) for these purposes. EFDS employs "data mining" computer scoring models for detecting fraud. Returns that are flagged are diverted into a workload for further inspection before any refund is issued. For a detailed discussion, *see* Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims that Happen to Trigger Systemic Filters, supra*.

71 TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 2012).

72 Treas. Reg. § 31.6109–2. IRS Notice 2011-6, 2011-3 I.R.B. 315, specifically excludes the Form W-7 from the list of forms requiring a PTIN.

73 *See, e.g.*, Circular 230, *Regulations Governing Practice before the Internal Revenue Service*; IRC § 7402(a).

TAS Visit to ITIN Operation Confirmed the Need for Modernization of the Technologically Obsolete Paper Process.

On September 18 and 19, 2012, TAS representatives visited the ITIN unit in Austin, TX. The visit showed that the employees do not use modern technology to process applications and detect potential fraud, instead manually verifying and processing a large number of paper files. Most ITIN examiners do not even have access to a telephone or IRS systems, other than the Real-Time System (RTS) for entering information about ITIN applications. The RTS itself is an outdated system that does not have fields for numbers, countries of issuance, and types of taxpayer documents proving identity, foreign status, or U.S. residency for tax purposes. For example, an ITIN examiner cannot enter the number or the date and the country of issuance of a passport for electronic screening of subsequent applications. Nor can he or she use face recognition software to identify multiple applications using the same photo identification. Further, RTS is an offline system that cannot communicate with other federal and state government databases to verify the taxpayer's identity.

To detect and deter fraud in the ITIN program, the IRS should modernize its processing technology to permit:

- Scanning and barcoding of incoming applications for future reference;
- Use of face recognition software and matching technology for screening applications, pictures, and signatures and comparing them with applications already in the database; and
- Automatic electronic verification with other federal, state, and foreign government agencies.[74]

If the IRS can electronically verify the validity of submitted documents, it would not need to require originals from applicants.

The IRS Should Address Unique Characteristics of Different Groups of ITIN Filers in Drafting New ITIN Rules.

As discussed above, the IRS's sweeping policy change based on a one-size-fits-all approach has imposed an unnecessary burden on different groups of ITIN applicants and may have had a chilling effect on filing compliance, as well as putting taxpayers at personal risk. Many taxpayer groups are not eligible for child tax credit and dependency exemptions and pose little or no risk of noncompliance. The IRS should take the demographics of taxpayer return claims into account and craft discrete exceptions for different groups of ITIN filers.

[74] For example, the United States Citizenship and Immigration Services (USCIS) E-Verify System verifies a foreign person's identity and status using its own, United States Department of State, and SSA data electronically. E-Verify now requires the foreign individual's passport number and the country of issuance. USCIS also administers a similar electronic Systematic Alien Verification for Entitlements (SAVE) program. SSA has a special arrangement for direct electronic access to state records (called SASPRO) such as those for human services (TANF/Medicaid/Food Stamps), wage, unemployment, vital statistics (birth/death records), and workers' compensation. The IRS should explore the availability of systems for electronic verification of documents submitted with ITIN applications.

Foreign Students, Researchers, Trainees, and Exchange Visitors

This group of taxpayers should be able to file W-7 applications throughout the year for themselves, their spouses, and dependents by attaching copies of identity and foreign status documents certified by a SEVP-approved school or organization. The National Taxpayer Advocate is pleased with the collaboration between TAS and the IRS on this issue. On October 2, 2012, in response to the National Taxpayer Advocate's and stakeholders' concerns, the IRS stated that taxpayers with a SEVIS record can submit copies of their documents proving identity and foreign status when certified by a SEVP-designated official.[75] However, ITIN applications from these taxpayers must still accompany a paper return unless they meet an exception.[76] Because these taxpayers pose little or no risk of using ITINs for a non-tax purpose, they should be allowed to apply for and obtain ITINs throughout the year, in advance of the filing season. This would allow them to file electronically and therefore significantly reduce their burden. It would also enable their returns to run through the IRS's regular refund fraud detection procedures, further mitigating risk of tax fraud.

Alien Taxpayers Submitting Copies of Public Documents Certified by an Apostille.

As a signatory to the Hague Convention, the United States agreed to recognize public (including notarized) documents issued by other signatory countries if those public documents are authenticated by the attachment of an internationally recognized form of authentication known as an apostille.[77] The apostille procedure allows public documents issued in one signatory country to be recognized as valid in another.[78] Apostilles may be issued only by a designated Competent Authority of a signatory country. Each Competent Authority is required to keep a register of apostilles it has issued that *any* interested person can access as an essential tool to combat fraud and verify the origin of an apostille in case of doubt.[79]

In January 2012, the Hague Conference on Private International Law (HCCH) and the National Notary Association of the United States of America (NNA) officially adopted the electronic Apostille Program (e-APP), a secure software that provides for the issuance of electronic apostilles (e-Apostilles) and verification of paper and electronic apostilles (e-Registers).[80] The e-APP (the e-Apostille and/or e-Register component) has been implemented in at least 14 countries, including the United States and Mexico, with other countries actively pursuing or considering implementation.[81] The IRS should immediately rescind

75 IRS, *IRS Clarifies Temporary ITIN Application Requirements for Noncitizens with Tax Extensions and Many Foreign Students* (Oct. 2, 2012).

76 *See* Instructions for Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Jan. 2012).

77 Hague Conference on Private International Law (HCCH), Outline, Hague Apostille Convention *available at* http://www.hcch.net/index_en.php?act=publications.details&pid=3121&dtid=2 (last visited on Sept. 24, 2012).

78 The main examples of public documents for which apostilles are issued in practice include birth, marriage and death certificates; extracts from commercial registries and other registers; patents; court rulings; notarial acts and notarial attestations of signatures; and academic diplomas issued by public institutions. HCCH, Outline, Hague Apostille Convention.

79 *Id.*

80 An e-Register under the e-APP allows for easy online verification that a presented Apostille has really been issued by the Competent Authority. HCCH, Operational E-Registers by State, *available at* http://www.hcch.net/index_en.php?act=text.display&tid=146 (last visited Sept. 24, 2012). HCCH and NNA successfully piloted the program since April 2006.

81 HCCH, Operational E-Registers by State, *available at* http://www.hcch.net/index_en.php?act=text.display&tid=146 (last visited Sept. 24, 2012).

its ITIN policy change, which effectively denies recognition of copies of public documents certified by an apostille (and violates the U.S. obligations under the Hague Convention), and find a way to routinely verify the validity of apostilles. With the majority of ITIN applications submitted by Mexican nationals, the IRS may be interested in developing an electronic tool to systemically verify the validity of Mexican apostilles through the e-APP process.[82]

Proper Oversight of the Certified Acceptance Agent Program Would Ensure the Validity of Foreign Documents and Alleviate Burden for ITIN Applicants.

According to Treasury Regulations and the controlling revenue procedure, other federal agencies, financial institutions, colleges and universities, and other authorized persons (including foreign persons) can certify copies of documents for ITIN applications.[83] As stated above, on June 22, 2012, the IRS stopped accepting copies of documents certified by CAAs, reacting to evidence of fraud by several "bad actors" identified in the TIGTA report.[84] Many stakeholders complained that instead of taking a timely enforcement action against unscrupulous CAAs, the IRS essentially ended the CAA program, creating undue burdens for honest taxpayers and compliant CAAs.[85]

The following persons, if authorized as CAAs, pose little or no risk for the integrity of the ITIN program:

- Colleges and universities (as described above);
- Other federal agencies, *e.g.*, the Social Security Administration or the United States Postal Service (which currently accepts U.S. passport applications);
- Financial institutions (broadly defined to include securities dealers, money services businesses, telegraph companies, etc.) that are required by law to verify and record the identity (name and address) and the TIN of the customer, *e.g.*, the passport number and the country of issuance for a foreign national;[86]
- Low Income Taxpayer Clinics;[87]
- Volunteer Income Tax Assistance sites that provide free services and lack a financial incentive to commit or aid and abet fraud;

82 About 72 percent of all ITIN applications came from nationals of Mexico in PY 2012. IRS response to TAS information request (Sept. 27, 2012).

83 Treas. Reg. § 301.6109-1(d)(3)(iv)(B); Rev. Proc. 2006-10, 2006-1 C.B. 293, § 4.02(1).

84 TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 2012).

85 *See, e.g.*, NCTC letter to the IRS Commissioner (Aug. 20, 2012); IRS and TAS teleconference with the members of the NCTC (Aug. 23, 2012).

86 *See generally* Bank Secrecy Act, 31 U.S.C. §§ 5311-5314, 5316-5322; 12 U.S.C. § 1829(b); USA PATRIOT ACT, § 326, Pub. L. No. 107-56, 115 Stat. 307 (2001); 31 C.F.R. §§ 1010.410, 1010.620, 1022.400. *See also* IRM 4.26.5.6 and IRM 4.26.5.6.1 (Oct. 3, 2012) (these requirements apply for a funds transmittal of $3,000 or more, and for any bank transaction over $100).

87 IRC § 7526; IRM 21.3.4.21.1 (Oct. 1, 2008). LITCs receive federal funding to provide education and outreach on the rights and responsibilities of U.S. taxpayers to individuals who speak English as a second language (ESL) and provide free or nominal fee legal assistance to low income taxpayers in resolving controversies with the IRS.

- Attorneys and Certified Public Accountants (CPAs) who are governed by their state licensing authorities and bound by ethical standards;[88]
- Enrolled Agents;[89] and
- Certain state government agencies, *e.g.*, Departments of Motor Vehicles, Departments of Social Services, and Boards of Education that have substantial experience in verifying the foreign persons' identity for state purposes.[90]

The ITIN program office (IPO) does not provide accurate or timely information to CAAs.[91] For example, in June 2009, IPO provided inaccurate information about CTC eligibility to CAAs on at least one occasion. In an IPO newsletter, CAAs were informed that the definition of qualifying child could also include "...other eligible person who lived with you all year as a member of your household."[92] Apparently, IPO paraphrased the qualifying relative relationship test and erroneously added it to the qualifying child relationship test in the context of explaining who could claim the child tax credit.[93] Even though a CAA pointed out the error, the IPO did not print a correction.[94]

The IRS should significantly revamp its CAA program to provide accurate and periodic training to CAAs, require all CAAs to take an annual competency examination like the return preparation exam administered to VITA volunteers, and require a due diligence statement regarding the accuracy of the ITIN application as well as any claims for the dependency exemption and CTC similar to IRS Form 8867, *Paid Preparer's Earned Income Credit Checklist*.[95] The IRS should also expand the program to include attorneys, CPAs, LITCs, VITA sites, and state government agencies. The program also would benefit from a process for electronic verification of CAA certifications where possible, and increased enforcement efforts against "bad actors."

CONCLUSION

Regardless of a taxpayer's immigration status or country of origin or residence, an efficient and equitable tax system does not distinguish between alien and other taxpayers with respect to taxpayer protection or customer service. The IRS should use a proactive approach to the ITIN application process, facilitating voluntary compliance and taking timely

88 These tax professionals are also subject to Circular 230 rules and the jurisdiction of the IRS Office of Professional Responsibility. It is highly unlikely that they will actively pursue ITIN application fraud.

89 An enrolled agent is a person who has earned the privilege of representing taxpayers before the IRS by either passing a three-part comprehensive IRS test covering individual and business tax returns, or through experience as a former IRS employee. *See* Treasury Department Circular No. 230, §§ 10.4-10.6, 31 C.F.R. §§ 10.4-10.6.

90 Certification of documents by state school boards may be particularly useful for verification of eligibility for a dependency exemption and CTC.

91 The IRS does not provide periodic trainings to CAAs.

92 IPO News 7 (June 2009).

93 *See* IRC § 152 (d)(2)(H).

94 Email from LITC Director to TAS (Oct. 3, 2012).

95 IRC § 6695(g) imposes a $500 penalty for the failure to comply with the EITC due diligence requirements. While the IRS may require CAAs to provide a due diligence checklist, it cannot impose penalties absent legislative change.

enforcement actions against perpetrators of fraud. While the National Taxpayer Advocate is pleased that the IRS now actively collaborates with TAS on ITIN issues, the IRS should consider inside and outside stakeholders' perspectives *before* significantly changing ITIN application procedures. Instead of employing a one-size-fits-all approach that harms future compliance by ITIN taxpayers, the IRS should specifically address refundable credit issues and CAA schemes identified in the TIGTA report.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Immediately rescind the June 22, 2012 requirement that ITIN applicants submit only original documents or documents certified by the issuing agency.
2. Accept copies of documents certified by an apostille in conformance with the U.S. obligations under the Hague Convention.
3. Accept copies of original documents certified by a SEVP-approved institution or an LITC.
4. Improve oversight of the CAA program, including periodic trainings to CAAs, an annual competency examination similar to the exam for VITA volunteers, and a requirement to provide a due diligence statement regarding the accuracy of the ITIN application, dependency exemption, and CTC claims, similar to EITC due diligence requirements.
5. Expand the CAA program to include attorneys, CPAs, LITCs, VITA sites, enrolled agents, and federal and state government agencies that have substantial experience in verifying foreign persons' identities.
6. Allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need.
7. Develop a process to retire ITINs that are no longer used for tax purposes; for example, in situations when the taxpayer leaves the country (as would a student) or receives an SSN, after communicating with the taxpayer.
8. Require ITIN employees to contact the ITIN applicant if a document is returned as undeliverable.
9. Amend the Form W-7 to allow applicants to provide alternative contact information of a third party designee for limited Form W-7 processing questions, similar to a field on a tax return.
10. Return the original documents by trackable mail service, such as certified, registered, or priority mail, and allow applicants who need their documents back faster an option to include a prepaid Express Mail or courier envelope.
11. Invest in modernization of the ITIN operation, including an update of the RTS software to include the document number and the country of issuance of a foreign document, a process for scanning and barcoding submitted documentation, and electronic

verification of documents with federal, state, and foreign (if possible) government databases and CAAs.

IRS COMMENTS

The IRS issued interim changes on June 22, 2012 to strengthen the procedures for issuing ITINs. Designed specifically for tax administration purposes, ITINs are only issued to people who are not eligible to obtain a Social Security number. After careful consideration, the IRS implemented these changes to protect the integrity of the application process while minimizing burden for applicants.

During the interim period, the IRS only issued ITINs when applications included original documentation, such as passports and birth certificates, or certified copies of these documents from the issuing agency. ITINs were not issued based on applications supported by notarized copies of documents. In addition, ITINs were not issued based on applications submitted through certifying acceptance agents unless they attached original documentation or copies of original documents certified by the issuing agency.

Some categories of applicants were not impacted by the interim changes including military spouses/dependents and nonresident aliens applying for ITINs for the purpose of claiming tax treaty benefits. The IRS also established exceptions to the interim procedures for certain types of applicants. On October 2, 2012, the IRS announced special instructions for the Student and Exchange Visitor Program (SEVP) and non-citizens with approved TY 2011 extensions. The original document requirement did not apply to these groups of taxpayers.

During the summer and fall of 2012, the IRS gathered feedback from stakeholders and interested groups on how to best safeguard the integrity of the ITIN program and improve applicant procedures.

Based on an extensive review of the ITIN application process along with feedback gathered from a variety of stakeholders, the IRS developed procedures for the 2013 filing season that will strengthen controls over the ITIN process. The IRS is also continuing this dialogue as we move forward in implementing these procedures. The IRS will maintain its new and stronger standard for issuing ITINs. ITIN applications will require original documentation, such as passports, birth certificates, or certified copies of these documents from the issuing agency. In addition, the IRS finalized its earlier decision of no longer accepting notarized copies of documents for ITINs to protect the integrity of the application process. The IRS recognizes the burden this may cause taxpayers and has identified exceptions and alternate methods to secure an ITIN without sending original documentation to the IRS. Though many of the interim guidelines from the summer were made permanent, others were modified based on feedback from key stakeholders. The changes will provide additional flexibility for people seeking ITINs while maintaining the stronger protection measures.

The IRS acknowledges there may be some additional burden with the IRS's policy change to require applicants to submit only original documents or documents certified by the issuing agency. The IRS is taking steps to relieve taxpayer burden while maintaining the integrity of the ITIN process. In addition to direct submission of documents to the IRS ITIN centralized site or use of Certifying Acceptance Agents, ITIN applicants will have several other avenues for verification of their documents. These options include providing full-service assistance for primary and dependent taxpayers at some key IRS Taxpayer Assistance Centers and our U.S. Tax Attachés in London, Paris, Beijing, and Frankfurt. In addition, Certifying Acceptance Agents, including those at the Low Income Taxpayer Clinics (LITCs) and Volunteer Income Tax Assistance (VITA) centers, may certify the original documentation of primary and secondary taxpayers. We have also retained the exception announced on October 2, 2012 for foreign students at educational institutions to be certified through the SEVP.

The Most Serious Problem suggests that the IRS is in violation of the Hague convention by requiring original documents. The IRS disagrees with this assertion. If the IRS generally accepted notarized copies of documents, then the IRS would be bound to accept notarized apostille copies from international sources under the Hague convention. Since the IRS no longer accepts notarized copies of documents, there is no requirement to accept apostille copies from international sources under the Hague convention.

Certified Acceptance Agents are an important intermediary in the ITIN application process. For processing year 2013, CAAs will be able to review original or certified copies from the issuing agency of identification documents from applicants and certify to the IRS that they verified the authenticity of the documents supporting the ITIN application. These face-to-face interviews of the primary and secondary applicants will help improve the integrity of the program while minimizing burden for applicants. ITIN applications for dependents submitted to the IRS by CAAs will continue to require original documents or copies certified by the issuing agency.

The application process for CAAs and AAs remains unchanged; however, there are new eligibility requirements for CAAs. The acceptance agent must be a U.S. or foreign person covered under Circular 230, and not under suspension or disbarment from practice before the IRS. This will include individuals who are attorneys admitted to the practice before the bar, Certified Public Accountants (CPA), Enrolled Agent (EA) and registered tax return preparers. The IRS recognizes that there are unique situations where it is not necessary to require a person to meet the Circular 230 eligibility requirements. IRS has granted exceptions to approved financial institutions, colleges, and universities, gaming industry, LITCs, and VITA centers.

As part of the application process, CAAs are required to complete an online course. Additionally, CAAs are required to successfully complete a forensic document identification training course. The IRS will increase compliance reviews using risk-based selection

criteria. Infractions are identified and classified as minor and major. Stricter penalties will apply to major infractions, and CAAs will be removed from the program for one year.

The IRS recognizes there is a need to keep tighter control over ITINs to prevent misuse of the numbers once assigned. Changes were made to ensure they are being used for legitimate tax purposes. A key change is that, for the first time, new ITINs will expire after five years. Taxpayers who still need an ITIN will be able to reapply at the end of the expiration period. This step will provide additional safeguards to the ITIN program to help ensure only people with legitimate tax purposes are using the numbers. In addition, the IRS will explore options, through engagement with interested stakeholder groups, for deactivating or refreshing the information relating to previously issued ITINs. The IRS agrees with the recommendation of the National Taxpayer Advocate that the IRS should develop a process to retire ITINs that are no longer used for tax purposes.

In addition to changes in the ITIN program, there will be further compliance checks on claims for credits including the Additional Child Tax Credit. For PY 2013, there will be a requirement to attach Form 8812, *Additional Child Tax Credit*, to the Form 1040 tax return. The Form 8812 will include statements about the residency of dependent children with ITINs. The IRS is also adding pre-refund compliance checks based on referrals from the ITIN employees and additional filters to identify fraud. There are steps in place during tax return processing to identify fraud, such as "funny box" procedures, the Electronic Fraud Detection System (EFDS), Accounts Management Taxpayer Assurance Program (AMTAP), and Dependent Database (DDb) filters. The IRS efforts to prevent fraud and ID theft within the ITIN program are balanced with the accessibility of an obtaining an ITIN for those taxpayers filing tax returns.

With respect to the recommendation that the IRS allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need, the IRS position remains unchanged. As mentioned in response to Most Serious Problem #8 in the 2010 Annual Report, the procedure of requiring a valid tax return with the Form W-7 application was designed to ensure that the ITIN assigned is used for its proper tax administration purpose. Associating the issuance of the ITIN with the filing of a tax return is still the only reliable method for the IRS to verify the number is being requested and properly used for tax administration purposes. As a result, ITINs are no longer issued solely based upon a statement that an applicant requires an ITIN in order to file a return without proof that the individual in fact needs the number to do so.

The IRS plans to make improvements in the following three areas noted in the draft Most Serious Problem: 1) making telephone contact with ITIN applicants, 2) returning documents by other than regular mail and 3) upgrading the RTS system. These are detailed more specifically in the following paragraphs.

With respect to the recommendation that ITIN employees contact the ITIN applicant if a document is returned undeliverable, the IRS agrees to do a study on undelivered ITIN

mail. Under consideration is a procedure requiring ITIN Tax Examiners to research the Integrated Data Retrieval System (IDRS) for a good mailing address. If none is found, the employee will send an email to the Entity function in Austin with the taxpayer's telephone number. An Entity employee will then call the taxpayer to identify a good mailing address. The study will track how many applications do not have telephone numbers and the successful and unsuccessful attempts by the Entity to reach the taxpayer by telephone. At the end of six months, the IRS will evaluate the results and determine whether to continue the procedure.

The IRS appreciates the recommendation of the National Taxpayer Advocate regarding the use of certified, registered, or priority mail to return original documents. The Form W-7 instructions will be updated with a note that applicants are permitted to include a prepaid Express Mail or courier envelope for faster return delivery of their documents. The IRS would then return the documents in the envelope provided by the taxpayer. This option will permit applicants to obtain an expedited level of mail service provided they are willing to bear the associated cost.

The National Taxpayer Advocate has also recommended that the IRS invest in modernization of the ITIN operation, including an update of the RTS software. The RTS is a web-based application designed as an inventory system. It currently captures the document number and country of issuance of documents submitted with Form W-7. The IRS agrees to evaluate the feasibility of an automated process to scan and electronically verify documents. If feasible, the IRS will take the necessary steps to request the required system architecture. System upgrades and enhancements are subject to funding and resource prioritization processes.

The IRS will continue to elevate the feedback of National Taxpayer Advocate, as well as all other stakeholders, as we determine if additional program improvements are needed in the future.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS has acknowledged the burden imposed on ITIN applicants by the interim ITIN application rules. We applaud the IRS's efforts to increase and improve its compliance checks on questionable claims for tax credits, including the Additional Child Tax Credit, recognizing that these return issues are separate and distinct from the application for the ITIN. We also appreciate the IRS's efforts to strengthen and improve the oversight of the Certifying Acceptance Agent program, including the requirement (with exceptions) for the CAA to be a regulated Circular 230 practitioner, to complete an online course, and to complete forensic training. Nonetheless, we encourage the IRS to provide periodic training to CAAs and develop and administer an annual competency examination for these agents.

The National Taxpayer Advocate remains concerned about the disproportionate burden imposed on families with dependents applying for ITINs. The new permanent ITIN rules issued on November 30, 2012 provide limited alternatives to the requirement to submit either original documents or copies certified by the issuing agency to the ITIN processing operation in Austin.[96] While the IRS has allowed CAAs to certify primary and secondary ITIN applicants' documents after an in-person appearance by the applicant, this option is not available for dependent applicants, as CAAs must collect and mail originals or copies certified by the issuing agency. For dependents, the only alternative to mailing original documents is to appear at "participating IRS Taxpayer Assistance Centers (TACs)," which are only authorized to certify copies of passports or national identification cards.[97] This is impossible for taxpayers with dependents residing abroad, while taxpayers in the United States with young children may be required to travel extensively if there is no TAC in their area.[98] In addition, many TACs require a valid U.S.- issued ID just to enter the building, which makes this option unavailable for many.[99] For taxpayers with dependents residing abroad, whose only option for presenting original documents in person is to appear at one of four U.S. tax attaché offices, there is simply no alternative but to mail documents to the IRS.

As discussed above, the requirement to submit original documents or copies certified by the issuing agency imposes a significant burden on families with dependents, who now comprise more than two thirds of all ITIN applicants, while at the same time reducing

96 IRS, *IRS Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season*, IR-2012-98 (Nov. 29, 2012).

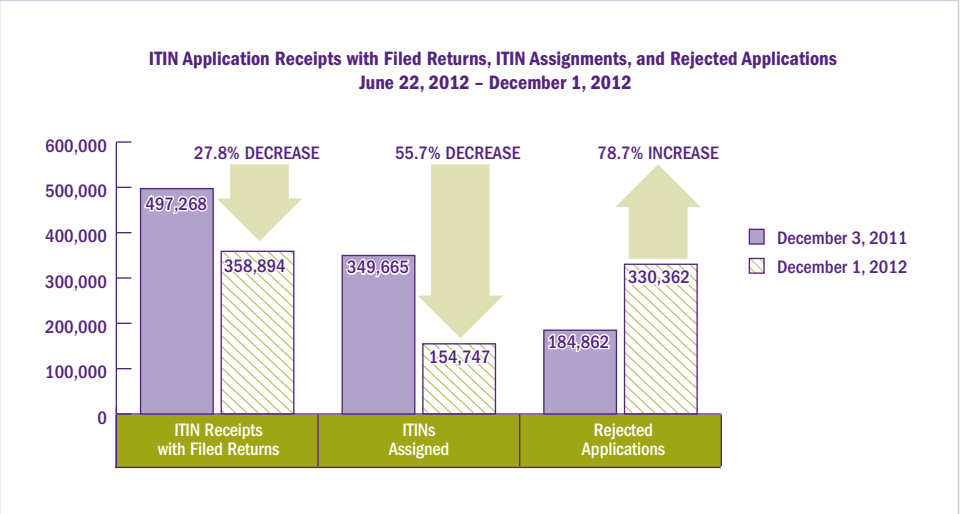
97 *See* IRS, *ITIN Policy Change Summary for 2013*, *available at* http://www.irs.gov/Individuals/ITIN-Policy-Change-Summary-for-2013. (last visited Dec. 7, 2012).

98 *See* Most Serious Problem: *The IRS Lacks a Servicewide Strategy That Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*, *infra*.

99 Representatives of Low Income Taxpayer Clinics raised concerns about the requirement of many TACs or federal buildings in which some TACs are located to produce a valid, U.S.-issued ID to enter the building. 2013 Annual Low Income Taxpayer Clinic Grantee Conference, *Recent Developments in IRS Policies and Procedures Related to ITIN Applications*, panel discussion (Dec. 6, 2012).

filing compliance.[100] Because of these new permanent rules, many dependents cannot travel with their families, as they wait more than two months — according to the IRS's own estimates — for the IRS to return their passports. As Figure 1.9.5 below shows, the volume of ITIN applications submitted with tax returns and the number of assigned ITINs substantially decreased from June 22, 2012, when the IRS announced the policy change, through December 1, 2012, compared to the same period in processing year 2011.[101] At the same time, the number of rejected applications increased significantly.

FIGURE 1.9.5, ITIN Application Receipts, Assignments, and Rejects



The IRS needs a workable solution that will not burden applicants or hinder filing compliance. One such option would be to allow CAAs, U.S. embassies and consulates, federal and state government agencies, and U.S. financial institutions to certify copies of a dependent's foreign documents by verifying that the original documents are authentic and the copies are exact copies of the originals. The CAA could send in the certified copies and allow the taxpayer to retain the original documents.

In addition, the IRS could accept copies of foreign documents certified by an apostille. The IRS does not acknowledge its responsibility to accept apostilles as valid certifications of original documents under the Hague Convention, rationalizing that the apostille is a mere notarization. This interpretation is both inaccurate and unproductive for the IRS's own purposes, because it ignores the definition and purpose of the apostille as a state certification of authenticity.[102] We submit that the state that issued the document is in the best

100 IRS response to TAS information request (Sept. 28, 2012). As of mid-2012, of the 906,848 total ITINs assigned, 614,714 were issued to dependents.

101 IRS, Real-Time System (RTS) reports (Dec. 1, 2012).

102 See Hague Apostille Convention; *see also* HCCH, The ABCs of Apostilles, *How to Ensure That Your Public Documents Will be Recognized Abroad*, Q&A 10, *available at* http://www.hcch.net/upload/abc12e.pdf (last visited Dec. 7, 2012).

position to authenticate its validity. The validity of an apostille can be easily verified by *any* interested person by accessing the apostille register maintained by a competent authority of each signatory country. Thus we recommend that the IRS reconsider its responsibilities regarding apostilles under the Hague Convention.[103]

While the National Taxpayer Advocate is pleased by the IRS's commitment to develop a process to retire ITINs not used for tax purposes, she is disappointed with the IRS's refusal to accept and process ITIN applications throughout a taxable year with proof of earned income. In addition to the automatic five-year expiration rule for newly assigned ITINs, the IRS should be able, after communicating with the taxpayer, to retire numbers that are no longer used for tax purposes, for example, where the taxpayer leaves the country (as would a student) or receives an SSN. If the IRS can deactivate an ITIN not used for a valid tax administration purpose, it has no basis for requiring concurrent filing of paper tax returns with paper ITIN applications.

More importantly, the IRS mischaracterizes the National Taxpayer Advocate's position with respect to accepting ITIN applications throughout the year. The National Taxpayer Advocate is not recommending that the IRS issue ITINs "solely based upon a statement that an applicant requires an ITIN in order to file a return without proof that the individual in fact needs the number to do so." Rather, the National Taxpayer Advocate has consistently recommended that the IRS allow taxpayers to submit ITIN applications throughout the year so long as they are accompanied by proof that the taxpayer has a filing requirement.[104] This proof can consist of multiple paystubs showing withholdings, an employment agreement, or other such documents. The IRS's refusal to eliminate procedures that create a bottleneck and prevent e-filing is also inconsistent with the IRS's own plans to consider the Form W-7 as a "candidate" for electronic filing.[105] The IRS should reconsider its position and allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need. We note that when ITIN returns are e-filed, they pass through IRS screens for identity theft and fraud protection. Thus, under our recommendation there would be no need for manual work-arounds.

We commend the IRS for initiating a study of undelivered mail to ITIN applicants and for its plans to revise procedures for telephone contact with applicants and return of documents by trackable mail service. We are also pleased that the IRS plans to enhance the RTS system, including an automated process to scan and electronically verify documents. We are looking forward to the IRS establishing a timeline for these changes. The IRS should

103 HCCH, Outline, Hague Apostille Convention.

104 *See e.g.*, National Taxpayer Advocate 2010 Annual Report to Congress 334, National Taxpayer Advocate 2008 Annual Report to Congress 140, National Taxpayer Advocate 2004 Annual Report to Congress 162, Taxpayer Advocate Directive (TAD) 2009-1 (Processing of Forms W-7/Filing of ITIN Applications and Associated Tax Returns) (Feb. 25, 2009).

105 *See* IRS Comments to the Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs* (stating "Forms 1040NR, *U.S Nonresident Alien Income Tax Return*, and W-7, *Application for IRS Individual Taxpayer Identification Number*, have been identified as candidate forms for electronic filing"), *infra/supra*.

not limit its provision of verifiable document returns to situations where taxpayers provide prepaid courier envelopes. It should return all documents via trackable mail service such as certified, registered, or priority mail. The IRS also should revise Form W-7 to include a field for contact information of a third party for limited processing questions, similar to a field on a tax return, and a PTIN of the paid preparer (if any).

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Permit CAAs, federal and state government agencies, and U.S. financial institutions to certify identity documents for dependent ITIN applicants, similar to current rules for CAA certification of documents for primary and secondary taxpayers.
2. Accept copies of documents certified by an apostille in conformance with the U.S. obligations under the Hague Convention.
3. Improve oversight of the CAA program, including periodic trainings to CAAs and an annual competency examination.
4. Allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need.
5. In addition to the automatic five-year expiration rule for newly assigned ITINs, develop a process to retire ITINs that are no longer used for tax purposes, for example, where the taxpayer leaves the country (as would a student) or receives an SSN, after communicating with the taxpayer.
6. Require ITIN employees to contact the ITIN applicant if a document is returned as undeliverable.
7. Amend Form W-7 to allow applicants to provide contact information for a third party for limited Form W-7 processing questions, similar to a field on a tax return.
8. Return original documents by trackable mail service, such as certified, registered, or priority mail.
9. Modernize the ITIN operation, including an update of the RTS software to include the document number and country of issuance of a foreign document, a process for scanning and barcoding submitted documentation, and electronic verification of documents with federal, state, and foreign (if possible) government databases and CAAs.

MSP #10 The Preservation of Fundamental Taxpayer Rights is Critical as the IRS Develops a Real-Time Tax System

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DEFINITION OF PROBLEM

In the 2011 and 2009 Annual Reports, the National Taxpayer Advocate wrote about the benefits of accelerated third-party information reporting to both taxpayers and tax administration.[1] In late 2011, the IRS held two public meetings to solicit suggestions and concerns from external stakeholders regarding a potential real-time tax system (RTTS).[2] Further, in the IRS's response to the 2011 Most Serious Problem, it committed to working with the National Taxpayer Advocate as it takes steps to realize its long-term vision of a real-time system.[3] We commend the IRS for prioritizing this issue and look forward to contributing to any future project. However, as the IRS continues to evaluate the idea of a real-time system, the National Taxpayer Advocate has the following concerns:

- When the IRS identifies a mismatch between third-party data and tax return information, it is unclear what type of compliance contact the IRS would make during the filing season before making an assessment. In addition, the level of taxpayer burden hinges upon the accuracy of the data, as well as the level of staffing allocated to problem resolution.
- We caution against the expansion of math error authority to cover mismatched third-party data. The National Taxpayer Advocate has written extensively about her concerns with the expansion of this authority.[4] This issue was also raised by the taxpayer and consumer advocate panel at the first RTTS public meeting.[5]
- The IRS should provide taxpayers with electronic access to the third-party data to help them prepare returns. To avoid inadvertent omissions of tax items on filed returns,

1 National Taxpayer Advocate 2011 Annual Report to Congress 284-295 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*); National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

2 IRS, IR-2011-114, *IRS to Host Public Meeting Dec. 8 on Real-Time Tax System* (Nov. 30, 2012), *available at* http://www.irs.gov/uac/IRS-to-Host-Public-Meeting-Dec.-8-on-Real-Time-Tax-System (last visited Oct. 24, 2012).

3 National Taxpayer Advocate 2011 Annual Report to Congress 284-295 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

4 *Id.* 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*).

5 IRS, Transcript of the Public Meeting on Real Time Tax System Initiative 92-94 (Dec. 8, 2011), *available at* http://www.irs.gov/Tax-Professionals/December-8,-2011-Meeting (last visited Oct. 24, 2012).

taxpayers and their representatives should have electronic access to a real-time transcript of data received by the IRS. The IRS would drive compliance rates even higher by providing a way for taxpayers to download the third-party data directly into their return preparation software and by developing a pre-populated return option for taxpayers.

ANALYSIS OF PROBLEM

Background

Approximately 97 percent of taxpayers receive at least one information return. Traditionally, the IRS has not matched this data with the items reported on the taxpayers' tax returns until long after the filing season has ended. The IRS has held several meetings with external stakeholders to solicit comments and suggestions regarding a potential real-time tax system. In general, any future RTTS would enable the IRS to match the information during the filing season and before releasing the associated refunds.[6]

In 2010, the IRS closed 4.3 million cases in which it identified a discrepancy between the taxpayer's return and third-party information, leading to $7.2 billion in additional assessments.[7] The real volume of mismatches is significantly larger, because this data only reflects mismatches large enough for the IRS to actually work them, and does not include others that did not reach the established threshold. For example, the IRS identified almost 23.8 million mismatches on tax year (TY) 2010 returns, but only worked about 5.3 million cases (22 percent).[8] If the IRS identified mismatches before releasing the refunds claimed on the returns, taxpayers would avoid the downstream consequences of these assessments.[9]

There is a General Consensus that Accelerated Information Reporting is Necessary.

In the 2011 and 2009 Annual Reports, the National Taxpayer Advocate wrote about the benefits of accelerated third-party information reporting to both taxpayers and tax administration.[10] The IRS solicited additional comments from a variety of stakeholders at two public meetings. During the meeting held on December 8, 2011, the IRS heard statements from the members of three panels: (1) tax practitioners, (2) federal and state government

6 IRS, PowerPoint, Real Time Tax System Initiative, Public Meeting 2 (Dec. 8, 2011), *available at* http://www.irs.gov/pub/irs-utl/rtts_deck.pdf (last visited Oct. 24, 2012).

7 *Id.*

8 IRS response to TAS information request (Oct. 17, 2012).

9 When the IRS's Automated Underreporter (AUR) system identifies a mismatch between items reported on the taxpayer's return and information reports, it generates a CP 2000 notice to be mailed to the taxpayer. In TY 2010, the IRS mailed 3,823,766 of these notices to taxpayers with an estimated 45 percent response rate. These numbers have actually decreased from 4,546,817 notices in TY 2009 (with an estimated response rate of 60 percent) and 4,788,360 notices in TY 2008 (with an estimated response rate of 57 percent). IRS response to TAS information request (Oct. 17, 2012) (data through Oct. 16, 2012).

10 National Taxpayer Advocate 2011 Annual Report to Congress 284-295 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*); National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

representatives, and (3) taxpayer and consumer advocates. The second meeting held on January 25, 2012 solicited comments from four panels comprised of (1) payroll/W-2 filers, (2) Form 1099 issuers, (3) software providers, and (4) state revenue agencies.[11] While the participants expressed concerns about how the IRS would achieve a real-time tax system, there was consensus that the goal of the initiative would serve both taxpayers and tax administration.[12]

Matching Third-Party Data to Filed Return Data Upfront Will Benefit Taxpayers and Save Resources for the Government.

If implemented properly, an RTTS could benefit taxpayers and the government. Matching third-party data upfront would substantially reduce taxpayer burden in several ways.

- First, taxpayers will be better equipped to answer questions about an underlying economic transaction if the IRS identifies the mismatch within months rather than a year or more after the fact.
- Second, matching data before the IRS releases refunds will prevent taxpayers from facing IRS collection actions long after they have spent the refunds.
- Third, taxpayers will save money by avoiding the long-term accrual of penalties and interest on unintentionally omitted or under-reported items.
- Fourth, upfront matching can potentially reduce taxpayers' vulnerability to identity theft-related refund fraud.[13]
- Finally, giving taxpayers access to third-party data before the return filing deadline will help them prepare returns and prevent inadvertent omissions and understatements.

The government also benefits from the revenue protection aspect of upfront matching. A real-time tax system would allow the IRS to protect revenue by resolving mismatches at the outset and preventing the release of erroneous refunds. The IRS would devote fewer resources to compliance and collection activities on these basic omission and understatement cases, and could use the savings to resolve more complex issues.[14]

11 For written and oral statements of panelists at the two RTTS public meetings, *see* http://www.irs.gov/Tax-Professionals/Real-Time-Tax-Initiative (last visited Oct. 24, 2012).

12 *Id*.

13 IRS, PowerPoint, Real Time Tax System Initiative, Public Meeting 1 (Dec. 8, 2011), *available at* http://www.irs.gov/file_source/pub/irs-utl/rtts_deck.pdf (last visited Oct. 24, 2012). For more information on identity-theft refund fraud, see Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft, supra*.

14 IRS, PowerPoint, Real Time Tax System Initiative 1, Public Meeting (Dec. 8, 2011), *available at* http://www.irs.gov/file_source/pub/irs-utl/rtts_deck.pdf (last visited Oct. 24, 2012).

The Preservation of Taxpayer Rights is Crucial as the IRS Identifies Mismatches Early in the Process.

As the IRS continues to solicit comments from stakeholders on a potential RTTS, the National Taxpayer Advocate raises the following concerns:

1. The IRS should carefully consider which type of compliance contact to make upon identifying a mismatch and ensure that it has adequate staffing to address taxpayer responses during the filing season;
2. The use of math error authority in this context could harm taxpayers, especially low income taxpayers; and
3. Taxpayers and representatives would benefit from electronic access to this data to assist in return preparation.

The Type of Compliance Contact Will Impact Taxpayer Burden.

The IRS has not committed to any particular compliance contact once it identifies a mismatch between the data reported by the taxpayer on the return and the data reported by third parties on information returns. Under the IRS's traditional Automated Underreporter (AUR) system,[15] an assessment of tax is already reported on the original return and the IRS applies deficiency procedures when it identifies a mismatch after the filing season. However, it is unclear exactly what would happen when the IRS identifies the mismatch *before* making an assessment.

While we agree that upfront matching will reduce taxpayer burden and save IRS resources in the long term, it will also prompt taxpayers to respond to the IRS no matter which compliance action the IRS takes. In customer satisfaction surveys conducted in fiscal year (FY) 2007 for the Wage and Investment (W&I) Division AUR program, at least 24 percent of taxpayers stated that their primary reason for calling the IRS was to have an employee explain the AUR notice.[16] Thus, sufficient staffing to handle the anticipated increase in taxpayer contacts is imperative to a successful initiative.[17] Any planned action by the IRS will occur during filing season when resources are already stretched. The IRS could cause significant upfront burden on taxpayers if it does not prepare for the increase in contacts during an already busy time.

The consequences of understaffing are illustrated by the IRS Wage Verification Program, in which the IRS holds the taxpayer's refund until it can verify the wages reported on the

15 The AUR program compares amounts shown on a taxpayer's return with third-party reports such as Forms W-2 and 1099 received and uploaded by the IRS. IRM 4.19.3.1.

16 This survey result indicates that the AUR notice and process was confusing to those taxpayers. Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2008-40-180, *Most Automated Underreporter Program Notices are Correct; However, Additional Oversight is Needed* (Sept. 25, 2008).

17 Similarly, the National Taxpayer Advocate has expressed concern regarding increasing volume of questionable refund claims that the Electronic Fraud Detection System (EFDS) stops without increasing AMTAP staffing to perform the required reviews. This leads to freezing taxpayer refunds for extended lengths of time while the IRS attempts to verify entitlements to claimed refunds. See National Taxpayer Advocate 2011 Annual Report to Congress 41. See also Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying Processing of Refunds That Trigger Systemic Filters*, *infra/supra*.

tax return, by either matching them to the Form W-2, *Wage and Tax Statement*, or contacting third parties directly. If the IRS verifies the wages and withholding as accurate, it releases the refund. When the IRS cannot initially verify wage and withholding documents systemically by comparing them to the Information Returns Master File (IRMF), it freezes the account. In the meantime, the IRS mails the taxpayer a letter requesting additional documentation and attempts to manually verify the wages by contacting the employer.[18]

For the most recent filing season, despite having access to third-party data earlier than in the past, the IRS froze approximately 142,000 accounts from April 28, 2012 through June 23, 2012.[19] In a review of TAS wage verification cases in FY 2012, TAS was able to obtain full relief in 78 percent and partial relief in two percent of these cases.[20] According to the IRS's own reports, nine percent of the cases the Accounts Management Taxpayer Assurance Program (AMTAP) selected for review (more than 92,000 as of June 31, 2012) were legitimate refund claims.[21] We suspect AMTAP is using hard freezes (refund holds that do not expire) as an inventory management tool due to overwhelming caseloads. Once it places a hard freeze on the account, the IRS can leave the returns to languish, as there is no pressure to work the case quickly.

Likewise, in the thick of the filing season when taxpayers are anticipating their refunds, any upfront matching associated with a real-time tax system could quickly overload IRS employees with inventory and jeopardize the taxpayers' due process rights, as follows:

- The IRS could inappropriately freeze many legitimate refunds.
- The IRS could issue unnecessary Statutory Notices of Deficiency, which would increase Tax Court litigation or audit reconsiderations. It is also unclear whether these taxpayers would receive pre-deficiency administrative appeal rights.
- Rather than freezing refunds, the IRS might use this increased workload to justify using math error authority to make any necessary adjustments.

The IRS Must Have Confidence in the High Degree of Accuracy of the Third-Party Data to Avoid Significant Taxpayer Burden.

For any future initiative to benefit both taxpayers and the IRS, the third-party data used to match to the taxpayers' returns must have a high degree of accuracy. In reality, the data received on information returns is not perfect. Although the IRS does not track corrected information documents, it guesses that less than one percent of information reports are

18 *See also* Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying Processing of Refunds That Trigger Systemic Filters, supra*.

19 Email from AMTAP (May 10 2012). In general, the IRS receives over 200 million valid W-2s for each tax year. SB/SE response to TAS information request (Sept. 12, 2012). For example, in calendar year 2011, the IRS received 228,231,132 Forms W-2. IRS Publication 6961, *2012 Update: Calendar Year Projections of Information and Withholding Documents for the United States and IRS Campuses, 2012-2020*, *Table 2*.

20 TAS analysis of CDW data from the Individual Returns Transaction File of 474 closed TAS cases with PIC 045 (Pre-Refund Wage Verification) pulled on October 5, 2012 (hereinafter "TAS 2012 Study").

21 W&I response to TAS information request (Aug. 28, 2012).

subject to subsequent amendments or corrections. Even if we accept the IRS's estimate, the number is still significant considering that the IRS receives approximately 1.8 billion information reports per year, of which only approximately 49 million were received on paper. Further, IRS projections show the number of information reports steadily increasing through 2020.[22] The taxpayers associated with these corrected reports might be entangled in the IRS enforcement procedures during the filing season through no fault of their own.[23] In addition, approximately 4.3 percent of AUR assessments in FY 2010 were abated. Specifically, 139,652 taxpayers received abatements on AUR assessments in FY 2010.[24] Therefore, the IRS already entangles compliant taxpayers in enforcement initiatives based on third-party data. This unnecessary burden is imposed on compliant taxpayers in the following scenarios:

1. The third-party data is inaccurate;
2. The taxpayer reported the income elsewhere on the return and the IRS did not review it closely enough; and
3. The IRS did not use its own internal information to verify the information reported on the return.

To illustrate the third point, in the 2011 annual report, TAS reviewed a sample of 2009 accounts in which the IRS reversed its math error adjustments related to dependent Taxpayer Identification Numbers (TINs). In these cases, the taxpayers received math error notices related to incorrect or missing dependent TINs that affected the dependency exemption, the related non-refundable additional child tax credit, or the Earned Income Tax Credit (EITC). The results of TAS's sample review showed that the IRS already had the information necessary to resolve 56 percent of these 2009 dependent TIN math errors and could have avoided the math error adjustments. Using readily available information to resolve TIN errors, such as information reported on prior year returns, would have prevented math error notices and delays in nearly 75,000 refunds. In addition, the IRS paid more than $2.3 million in interest for corrected math errors in these cases.[25]

Further, in cases before the Tax Court, the burden of proof for a deficiency of tax shifts to the IRS if the deficiency is based solely on information included on a third-party information report.[26] Therefore, the IRS has an additional incentive to adopt procedures to attempt

22 IRS Publication 6961, *2012 Update: Calendar Year Projections of Information and Withholding Documents for the United States and IRS Campuses, 2012-2020*, Tables 2, 3.

23 IRS, PowerPoint, Real Time Tax System Initiative 2, Public Meeting (Dec. 8, 2011), *available at* http://www.irs.gov/pub/irs-utl/rtts_deck.pdf (last visited Oct. 24, 2012).

24 In FY 2010, approximately $1.05 billion of the approximately $6.9 billion tax assessed through AUR was abated (15.2 percent). In FY 2011, 68,984 taxpayers (or 2.1 percent) received approximately $307 million in abatements (5.2 percent of the tax assessed through AUR was abated). IRS Enforcement Revenue Information System's FY 2011 database.

25 See National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, 119-120.

26 IRC § 6201(d). In order for the burden to shift to the IRS in a Tax Court case, the taxpayer must assert a reasonable dispute to the IRS within a reasonable time and must have fully cooperated with the IRS.

to verify third-party data through other means, especially through information available internally, to screen out false positives or mismatches before taking enforcement actions.

The burden on these taxpayers will increase if they are dealing with these issues during the filing season when IRS resources are already scarce and the taxpayer must wait to receive a legitimate refund. These problems will worsen as the IRS increases the volume of third-party data it receives under new initiatives, including several new third-party information reporting requirements. Most notably, credit card issuers generally must report the aggregate amount of reportable payments they process for businesses,[27] and brokerage firms generally must report the cost bases (as well as gross proceeds) of stock, bond, and mutual fund sales.[28] Thus, not only will the IRS receive significantly more data in the future, but it will also be expected to process it earlier. Therefore, even a low error rate will translate into substantial costs to the IRS and increased burden on the taxpayers.

Any Acceleration of Third-Party Information Report Processing May Impact Third-Party Payers.

While the acceleration of the processing of third-party information reports will benefit both taxpayers and the IRS, the impact on third-party payers cannot be overlooked. Any acceleration of deadlines will potentially burden this population. Therefore, the IRS should work with these stakeholders to determine the best way to accomplish a real-time tax system.

The following table sets forth the deadlines for common information reports. With most of the forms listed below, the payer must submit the form to the payee by January 31, which is generally one or two months before the deadline to submit it to the IRS, depending whether the payer files the form on paper or electronically.

27 IRC § 6050W. The projected filings of Form 1099-K, *Merchant Card and Third Party Payments*, will see an increase from approximately nine million projected filings in calendar year 2012 to almost 22 million projected filings in CY 2020. IRS Publication 6961, *2012 Update: Calendar Year Projections of Information and Withholding Documents for the United States and IRS Campuses, 2012-2020, Table 2*.

28 IRC § 6045(g).

TABLE 1.10.1, Current Deadlines for Filing Information Reports[29]

Type of Information Report	Deadline to Submit to Payee	Deadline for Paper Filing	Deadline for Electronic Filing
1098-T	January 31st	February 28th	April 1st
1099-DIV	January 31st	February 28th	April 1st
1099-INT	January 31st	February 28th	April 1st
1099-Misc	January 31st (extended to Feb. 15th in certain circumstances)	February 28th	April 1st
1099-R	January 31st	February 28th	April 1st
W-2 (to SSA)	January 31st	February 28th	March 31st

The National Payroll Reporting Consortium has noted that the March 31 / April 1 deadline was initially established as an e-file incentive, which may not be necessary today. The group also points out that the later deadline is likely responsible for the low level of amendments to W-2s, as an earlier deadline would probably translate into a higher rate of amendments. The Consortium estimated the rate would rise from approximately one percent to a range of six to eight percent, due to the complex compensation and benefits offerings of large employers, but added that six states and the District of Columbia already require employers to report W-2s by January 31.[30] Thus, it would be in the IRS's best interest to evaluate the amendment rates experienced by these jurisdictions in determining the most effective method to accelerate third-party reporting.

In addition, if the IRS experiences a high amendment rate for certain information reports, it should evaluate different ways to reduce amendments, with a customized approach for each type of report. For example:

- **Bifurcate Information Report Filing Deadlines.** If certain data on an information report lends itself to delays in reporting due to complexity or record-keeping issues, the IRS could bifurcate the information report deadlines. For example, if employers need more time to report pension benefit calculations, the IRS could require earlier reporting of the basic Form W-2 data such as wages and withholdings and give employers time to file a supplemental earnings statement with the more complicated items later. Taxpayers and the IRS would receive the information they need for return filing early in the filing season and the IRS would receive the other, more complex information soon enough for compliance purposes.

29 IRS, *General Instructions for Certain Information Returns — Main Contents, available at* http://www.irs.gov/instructions/i1099gi/ar02.html#d0e400 (last visited Oct. 12, 2012); *Instructions to IRS Form 1098-T, Tuition Statement; Instructions to 1099-DIV, Instructions to IRS Form 1099-INT, Interest Income; Instructions to IRS Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc*, Social Security Administration, Deadline Dates to Submit W-2s, *available at* http://www.ssa.gov/employer/filingDeadlines.htm (last visited Oct. 12, 2012).

30 IRS Public Hearing, *Proposed Real-Time Tax System, Comments from the National Payroll Reporting Consortium* (Jan. 25, 2012).

- **Build flexibility into the reporting period.** The IRS should evaluate the feasibility of providing an option for payers to report certain complex transactions occurring during the last two months of the year on the return for the subsequent tax year.[31]

Any Planned Expansion of Math Error Authority in This Context Could Harm Low Income Taxpayers.

We caution against the expansion of math error authority in the context of real-time information reporting.[32] In the 2011 Annual Report, the National Taxpayer Advocate discussed how the inappropriate expansion of math error authority places significant burden on taxpayers and erodes taxpayer protections.[33] Moreover, serious concerns about the application of math error authority to RTTS were raised by the consumer and taxpayer advocate panel of the December 8, 2011 public meeting for RTTS. Specifically, in his written statement, Keith Fogg, Director of the Villanova Law School Federal Tax Clinic, stated:

> Another factor to consider with the Real Time information concerns its use in the absence of taxpayer consent. Many taxpayers will not agree to an additional liability based on the finding of a mismatch of information either because of genuine disagreement, a failure to respond or a lack of comprehension. Faced with a return that appears wrong at a point prior to assessment (and refund), the Service will want to include this information into the liability calculus. It may quickly turn to the math error process as a source of increasing the assessment over the liability shown on the return.
>
> The Government Accountability Office has recently proposed increasing the authority of the Service to make math error adjustments for certain refundable credits. The math error process sings a siren song of efficient tax administration yet it holds significant problems particularly for low income taxpayers who do not understand and do not respond quickly to these notices. The math error process gives taxpayers less time to react before a proposed adjustment is assessed than the notice of deficiency process (60 versus 90 days); less notice of what is proposed; and fewer rights with respect to information returns — the very subject of the Real Time initiative. In a shorter period of time, with less explanation than exists in a notice of deficiency, a taxpayer can see rights cut off and an assessment made.
>
> Low income taxpayers are more likely than other taxpayers to fail to speak up during the period of math error adjustment and more likely to lose their right to contest the adjustment in Tax Court. Once they lose their prepayment forum, low income taxpayers also possess less financial capability to pay the tax and sue

31 IRS Public Hearing, *Proposed Real-Time Tax System, Comments from the National Payroll Reporting Consortium* (Jan. 25, 2012). The IRS already allows this for certain fringe benefits. See Announcement 85-113, 1985-31 I.R.B. 31 (Aug. 5, 1985).

32 IRC § 6213.

33 See National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*).

> for refund when faced with an incorrect assessment. This forces them into the audit reconsideration process where no recourse to the courts exists. If math error authority expands to include the types of adjustments suggested by mismatches of data, the Real Time program simply accelerates the AUR process into a preassessment time frame. This would significantly disadvantage low income taxpayers who are the least responsive to notices received from the Service. Safeguards must exist to keep this from becoming the result of this change. Those safeguards could involve use of the deficiency process rather than the math error process, significant enhancements in the math error notices or other processes that will adequately safeguard low income taxpayers and their opportunities to contest proposed adjustments.[34]

The National Taxpayer Advocate shares concerns that the application of math error authority to upfront matching during the filing season would erode taxpayer rights. She is also concerned about the impact such an initiative would have on the low income taxpayer population.

Direct Electronic Access for Taxpayers Would Improve Compliance.

Providing taxpayers and their representatives with direct electronic access to their third-party information would prevent mismatches from occurring in the first place. Consider taxpayers who have worked several different jobs during the tax year and moved after completing one job early in the year. If the W-2 or 1099 associated with the first job is not properly forwarded to the taxpayer's current address, he or she could inadvertently omit the item from the return and not realize it until the IRS sends the taxpayer a CP 2000 notice. To address this issue of inadvertent omissions, the IRS should provide access to real-time transcripts of third-party data to aid in return preparation. Taxpayers and preparers could refer to the transcript to make sure they do not inadvertently omit any income. In fact, this issue was raised on the practitioner panel during the December 8 public meeting.[35]

One step above the transcript would be to provide a platform from which taxpayers and preparers could download third-party data submitted to the IRS or the Social Security Administration directly into tax preparation software. This second option would eliminate transcription errors and provide a one-stop-service to taxpayers who would not need to download the data separately from each third party. Finally, the IRS should follow the lead of other countries and provide taxpayers with an option to use a preliminary return pre-populated with information submitted to the IRS through third party reports.[36]

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34 Comments of T. Keith Fogg, Director, Villanova Law School Federal Tax Clinic, Real Time Tax System Initiative (Dec. 8, 2011), *available at* http://www.irs.gov/pub/irs-utl/t._keith_fogg_aba_tax_section_and_low_income_tax_clinic.pdf (last visited Aug. 2, 2012).

35 IRS, Transcript of the Public Meeting on Real Time Tax System Initiative 42 (Dec. 8, 2011), *available at* http://www.irs.gov/Tax-Professionals/December-8,-2011-Meeting (last visited Oct. 24, 2012).

36 For a detailed discussion of the pre-filled return options available in other countries in 2009 and expected in 2012, see Organisation for Economic Co-Operation and Development, Centre for Tax Policy and Administration, Forum On Tax Administration: Taxpayer Services Sub-Group, *Survey of Trends and Developments in the Use of Electronic Services for Taxpayer Service Delivery* 34-38 (March 2010).

CONCLUSON

The IRS is evaluating the feasibility of developing a real-time tax system. The National Taxpayer Advocate continues to believe that accelerating third-party data matching to occur during the filing season would reduce taxpayer burden and save government resources. However, it is imperative that any such system maintain taxpayer protections.

IRS COMMENTS

As discussed in the report, the IRS has been taking steps toward the early development of a real-time tax system. The goal of this initiative is to improve the tax filing process by both reducing burden for taxpayers and improving overall compliance upfront.

This is a long-term vision that will take years to fully realize. Over the last year, the IRS has been soliciting feedback and input from outside stakeholders on issues related to the concept. We have held public meetings and talked to a variety of groups representing varying perspectives and will continue these dialogues into the future.

The IRS recognizes that taxpayer rights must be preserved in any changes that may take place. While it is premature to speculate on the specifics of any future state, the IRS will continue to ensure that taxpayer rights are respected. We look forward to working with the National Taxpayer Advocate in this effort.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS recognizes the value of a real-time tax system in reducing taxpayer burden and increasing overall compliance. We believe the IRS is taking appropriate steps by soliciting comments and perspectives from a variety of internal and external stakeholders in the planning stages of the initiative. However, we are concerned that the IRS has not shared the findings of any discussions held since the public meetings and has not publicly committed to any goals with specific timeframes. We accept the IRS's offer to actively engage the participation of the Taxpayer Advocate Service as it continues to plan and subsequently develop specific procedures for the initiative to ensure that taxpayers' rights are protected.

In addition to upfront matching in a real-time tax system, we believe that the IRS could minimize taxpayer burden and drive compliance rates even higher by providing taxpayers with electronic access to the third-party data to assist in return preparation. Taxpayers and their representatives would avoid inadvertent omissions of tax items on filed returns if they had access to a real-time transcript of data received by the IRS. The IRS could further reduce burden and increase compliance by providing a way for taxpayers to download the

third-party data directly into their return preparation software and by developing a pre-populated return option for taxpayers.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Work with the National Taxpayer Advocate in developing a real-time tax system. Legislative action may be necessary to accelerate third-party reporting deadlines, tighten e-file mandates, and enable the IRS to receive Form W-2 data at the same time taxpayers receive forms from their employers.
2. Develop accelerated information-reporting procedures that afford taxpayers the same rights that accrue during a traditional examination.
3. Allocate sufficient staffing to handle the anticipated increased in taxpayer contacts during the filing season.
4. Provide taxpayers and their representatives access to a real-time transcript of third-party information to assist in return preparation.
5. Provide taxpayers with the ability to download third-party data directly from the IRS into their return preparation software.
6. Develop a pre-populated return option for taxpayers.
7. Track corrected information reports, by count, dollar amount, and percentage of total reports by type as well as the rate of abatements for AUR assessments. In addition, track the abatement rate for any new assessments arising from real-time matching.

MSP #11 Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process are Burdening Tax-Exempt Organizations

RESPONSIBLE OFFICIAL

Joseph H. Grant, Acting Commissioner, Tax Exempt and Government Entities Division

DEFINITION OF PROBLEM

Over the past 18 months, as mandated by the Pension Protection Act of 2006, the IRS notified more than 440,000 organizations that their tax-exempt status had been automatically revoked because they failed to file required returns or notices for three consecutive years.[1] The IRS included these organizations on a list of those whose exempt status had been revoked, and, if they appeared on it, removed their names from another list of permissible recipients of tax-deductible contributions.

The National Taxpayer Advocate had several concerns about the manner in which the IRS would administer the automatic revocation process, and her concerns have been borne out.[2] For example:

- The IRS requires organizations seeking reinstatement to submit IRS Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, the same form about 60,000 other organizations file each year to request initial recognition of exempt status;[3]
- The increased volume in applications for exempt status coincides with staff reductions, so that fiscal year (FY) 2012 inventory is expected to be more than double the FY 2010

1 The Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006). The IRS notified organizations that they were no longer exempt beginning in June 2011. *See IRS Identifies Organizations that Have Lost Tax Exempt Status; Announces Special Steps to Help Revoked Organizations* (June 8, 2011), *available at* http://www.irs.gov/newsroom/article/0,,id=240239,00.html. An IRS online resource, Select Check, available at http://apps.irs.gov/app/eos/, includes a searchable list of organizations whose tax-exempt status was automatically revoked. As of August 9, 2012, there were 443,441 organizations on the list.

2 National Taxpayer Advocate 2011 Annual Report to Congress 437 (Status Update: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*).

3 *Hearing on Public Charity Organizational Issues, Unrelated Business Income Tax, and the Revised Form 990,Hearing before the H. Comm. On Ways and Means, Subcomm. on Oversight*, 112th Cong. 2nd Sess., (July 25, 2012) 2 (testimony of Steven T. Miller, Deputy Commissioner of Services and Enforcement, Internal Revenue Service), *available at* http://waysandmeans.house.gov/UploadedFiles/Miller_Testimony_7.25.pdf (noting that "We consistently receive about 60,000 applications for tax-exempt status each year. Most are requesting status under section 501(c)(3).").

level, and applications that require assignment to a reviewer now take nine months to be assigned;[4]

- Taxpayers who call the IRS for assistance will wait on average almost 20 minutes for assistance (up from ten minutes last year and seven minutes in 2010), and almost 40 percent of calls will go unanswered (up from 24 percent last year and 19 percent in 2010);[5]
- The IRS erroneously treated thousands of organizations as no longer exempt, yet does not provide administrative review that might have averted the errors or lessened their impact;[6] and
- TAS case receipts with exempt organization issues have increased more than fourfold from 2010 to 2012, a clear indication that the IRS's processes are causing significant hardship for these organizations.

The IRS provided transition relief for small organizations and is addressing the cause of a substantial number of automatic revocations. However, the reinstatement process remains unnecessarily burdensome and administrative review of automatic revocations is still unavailable. By every meaningful measure of taxpayer service, taxpayers are being harmed.

ANALYSIS OF PROBLEM

Background

The Pension Protection Act of 2006:

- Imposed a new annual reporting requirement, Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt EOs Not Required to File Form 990 or 990-EZ,* on small exempt organizations (EOs);[7]

4 Tax Exempt and Government Entities (TE/GE) Division Business Performance Review (BPR) FY 2012: Second Quarter 15 (May 23, 2012) *available at* http://tege.web.irs.gov/lib/my-resources/TEGE_BPR_2nd_Quarter_FY2012.pdf (reporting that there were 15,570 open determination cases in fiscal year (FY) 2010 and that TE/GE expects to have 40,304 open determination cases in FY 2012). *See* Where Is My Exemption Application?, *available at* http://www.irs.gov/charities/article/0,,id=156733,00.html, showing that in August 2012 TE/GE was assigning applications that were submitted in November 2011. Not all applications for exempt status must be assigned to a reviewer. For "plain vanilla" applications that do not require further development, the IRS either issues a determination letter or requests additional information within approximately 90 days. The IRS does not maintain information about processing times broken down by requests that can be disposed of at a screening stage and those that require further development. IRS response to TAS information request (Aug. 26, 2011).

5 TE/GE BPR FY 2012: Second Quarter 27 (May 23, 2012) *available at* http://tege.web.irs.gov/lib/my-resources/TEGE_BPR_2nd_Quarter_FY2012.pdf.

6 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2012-10-027, *Appropriate Actions Were Taken to Identify Thousands of Organizations Whose Tax-Exempt Status Had Been Automatically Revoked, but Improvements Are Needed* 9 (Mar. 30, 2012).

7 IRC § 6033(i). Under IRC § 501(a) and (c)(3), some organizations (exempt organizations or EOs) devoted to charitable, religious, educational, or certain other purposes may be exempt from federal tax. Formerly, under IRC § 6033(a)(3)(A)(ii), these EOs with annual gross receipts of normally not more than $5,000 were not required to file annual reports such as Form 990, *Return of Organization Exempt from Income Tax, or Form 990-EZ, Short Form Return of Organization Exempt from Income Tax*. With Rev. Proc. 83-23, 1983-1 C.B. 687, the IRS increased the gross receipts amount to $25,000. For tax years beginning on or after January 1, 2012, the gross receipts amount is $50,000. Rev. Proc. 2011-15, 2011-3 I.R.B. 332. Exceptions to the new reporting requirement include churches, their integrated auxiliaries, and conventions or associations of churches.

- Provided for automatic revocation of tax-exempt status for failing to file a required return or e-Postcard for three consecutive years;[8] and
- Required an application for reinstatement of exempt status.[9]

The IRS can reinstate an organization's exempt status retroactively to the date of automatic revocation if the organization shows reasonable cause for its failure to file the required return or e-Postcard.[10] Under transitional relief provisions, the IRS will treat some organizations as having the requisite reasonable cause if they applied for reinstatement by December 31, 2012. Eligible organizations are those that were revoked for not filing a return or e-Postcard for their 2007, 2008, and 2009 tax years. In addition, to be eligible for transition relief, organizations must have:

- Had annual gross receipts of not more than $50,000 in the most recently completed tax year;
- Not been required to file a Form 990 or 990-EZ prior to 2007; and
- Been eligible to file an e-Postcard in 2007, 2008, and 2009.[11]

These organizations can submit applications with a reduced user fee of $100.[12]

The IRS implemented the Pension Protection Act by informing EOs of the new filing requirements, notifying them when their exempt status had been automatically revoked, and listing them on its Select Check database as having had their status automatically revoked. As of August 9, 2012, 443,441 EOs were listed as no longer exempt.[13] As of June 7, 2012, more than 18,000 organizations had applied for reinstatement.[14] Using the transitional relief provisions, as of June 7, 2012, the IRS had reinstated the exempt status of almost 8,000 organizations retroactively.[15] However, despite the National Taxpayer Advocate's urging,

8 IRC § 6033(j).

9 IRC § 6033(j)(2) provides that an organization must reapply for reinstatement following automatic revocation even if it was not required to apply for initial recognition of its tax exempt status.

10 IRC § 6033(j)(3).

11 Notice 2011-43, 2011-25 I.R.B. 882. For tax years beginning on or after January 1, 2010, organizations with gross receipts normally of $50,000 or less may submit Form 990-N (e-Postcard). Rev. Proc. 2011-15, 2011–3 I.R.B. 322 (an increase from the earlier threshold of $25,000 or less).

12 Rev. Proc. 2011-36, 2011-25 I.R.B. 915. The user fee for filing Form 1023 is usually $400 for EOs with gross receipts of $10,000 or less and $850 for those with gross receipts in excess of $10,000. Rev. Proc. 2012-8, 2012-1 I.R.B. 235.

13 Select Check, *available at* http://apps.irs.gov/app/eos/. In addition to containing a searchable list of organizations whose tax exempt status was automatically revoked, the tool provides searchable lists of organizations eligible to receive tax-deductible charitable contributions and organizations that have filed an e-Postcard.

14 IRS response to TAS information request (Aug. 2, 2012). TE/GE received 11 applications for reinstatement in 2010, 6,199 in 2011, and 12,269 as of June 7, 2012. TE/GE closed 9,504 of these applications. *Id.*

15 *Id.* TE/GE closed 7,908 applications for reinstatement pursuant to Notice 2011-43, with almost all applicants receiving retroactive reinstatement. The IRS also reinstated 1,596 organizations other than under the transitional relief provisions. The vast majority (1,390, or 87 percent) of these organizations had annual gross receipts of less than $200,000 and only 26 obtained retroactive reinstatement. *Id*.

the IRS does not provide administrative review of its decision to treat an organization as having had its exempt status automatically revoked.[16]

Automatic Revocations and Reduced Staff Cause Delays.

The IRS's Exempt Organization (EO) Rulings and Agreement staff in its Cincinnati Determinations office evaluate requests for reinstatement along with the approximately 60,000 routine applications for exempt status (*i.e.*, not resulting from automatic revocations) the IRS receives each year.[17] From 2009 to 2011, when the IRS issued the first notifications of automatic revocation, the number of full-time employees in the Determinations office decreased by about seven percent.[18] The volume of applications for reinstatement of exempt status and the number of employees who handle them are shown in Figure 1.11.1.

FIGURE 1.11.1, Full-Time Cincinnati Determinations Staff vs. Applications for Reinstatement of Exempt Status[19]

16 National Taxpayer Advocate 2011 Annual Report to Congress 562 (Legislative Recommendation: *Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*).

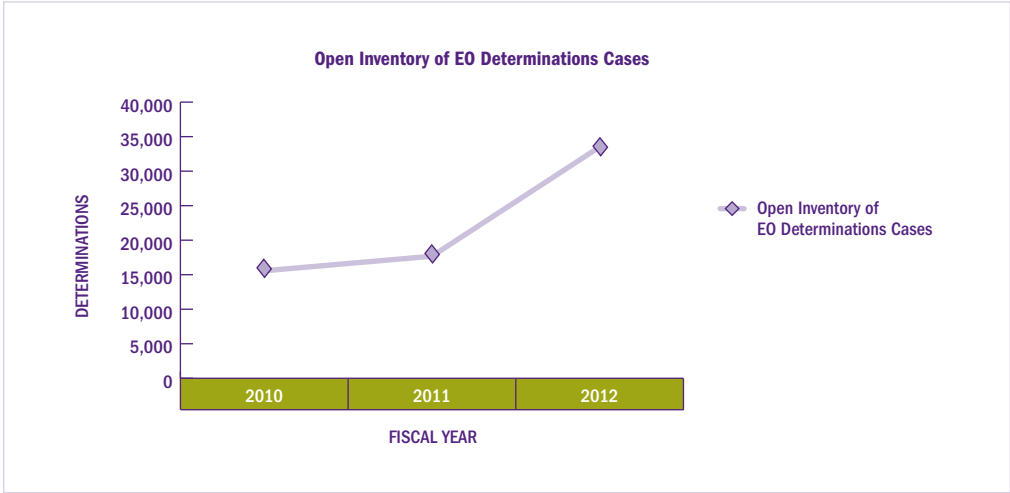
17 IRS response to TAS information request (Aug. 2, 2012). In its BPR, EO reports on its "determination case receipts." Determination cases include applications submitted on Form 1023 as well as those submitted on Form 1024, *Application for Recognition of Exemption Under Section 501(a),* and also other determinations such as public charity and private foundation status determinations, advance approval of scholarship grant procedures, and group determinations of tax-exempt status. IRS response to TAS information request (Aug. 26, 2011). For FY 2009, before there were any requests for reinstatement, determination case receipts were 71,836. TE/GE BPR FY 2011: Fourth Quarter 16 (Nov. 15, 2011), *available at* http://tege.web.irs.gov/lib/my-resources/TEGE_BPR_4th_Quarter_FY2011.pdf. For FY 2010, determination case receipts were 65,545, of which 11 were requests for reinstatement. For FY 2011, determination case receipts were 66,038, of which 6,199 were requests for reinstatement, leaving 59,839 routine requests. TE/GE BPR FY 2012: Second Quarter 15 (May 23, 2012) *available at* http://tege.web.irs.gov/lib/my-resources/TEGE_BPR_2nd_Quarter_FY2012.pdf.

18 AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section, https://persinfo.web.irs.gov/track/workorg.asp (showing all fulltime Cincinnati Determinations employees as 221, 208, and 206 as of the end of September in 2009, 2010, and 2011 respectively, a decrease of 6.8 percent).

19 AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section, https://persinfo.web.irs.gov/track/workorg.asp.

The consequence of the increased volume in applications handled by the same (or slightly smaller) Cincinnati Determination staff has been an increase in EO's inventory of open (*i.e.*, unresolved) cases, as shown in Figure 1.11.2. The expected volume of open inventory for FY 2012 is more than double the FY 2010 level, increasing from 15,570 cases in FY 2010 to 33,505 expected in FY 2012.

FIGURE 1.11.2, EO Determinations Inventory[20]

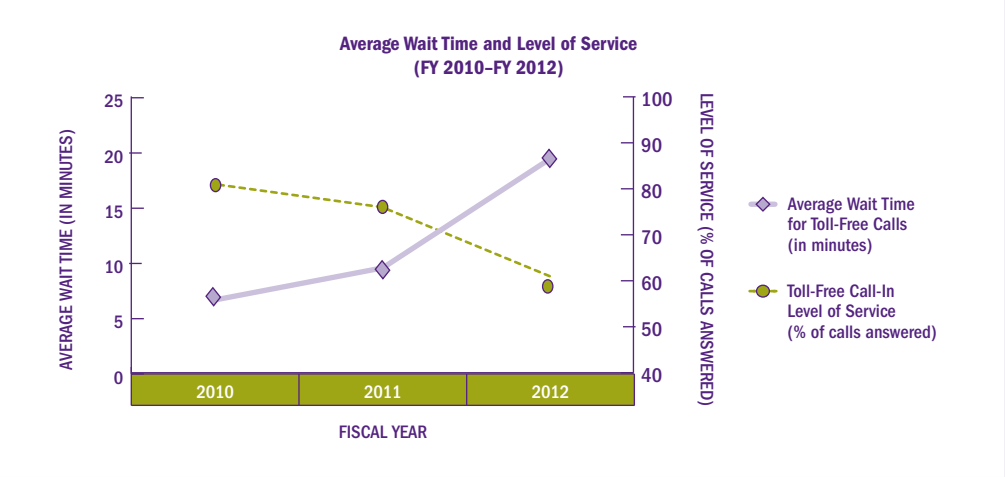


Applications that require assignment to a reviewer now take nine months to be assigned, up from the seven months cited in last year's Annual Report as the time it takes to assign a Form 1023 to a reviewer.[21] Taxpayers who call TE/GE's toll-free number for information now wait longer to have their calls answered (an almost 20-minute wait time is expected for FY 2012, up from seven minutes in FY 2010), and almost 40 percent of calls are expected to simply go unanswered, compared to only 19 percent unanswered in FY 2010, as shown in Figure 1.11.3.

20 The FY 2010 open inventory consisted of 15,570 determinations cases. For FY 2011, the level was 17,677 cases, and for FY 2012, the level is expected to arrive at 33,505 cases. TE/GE BPR FY 2012: Second Quarter 15 (May 23, 2012) *available at* http://tege.web.irs.gov/lib/my-resources/TEGE_BPR_2nd_Quarter_FY2012.pdf.

21 *See* National Taxpayer Advocate 2011 Annual Report to Congress 449; Where Is My Exemption Application?, *available at* http://www.irs.gov/Charities-&-Non-Profits/Where-Is-My-Exemption-Application%3F.

FIGURE 1.11.3, Average Wait Time for TE/GE Toll Free Calls vs. Percent of Calls Answered[22]



Some taxpayers who needed assistance came to TAS; TAS case receipts with EO technical or Form 1023 processing issues jumped from 303 in FY 2010 to 1,666 in FY 2012, an increase of 450 percent.[23] This increase in TAS EO cases demonstrates that the IRS's processes are creating significant hardship for both new EOs and those whose exempt status was automatically revoked.[24]

In the two years preceding the automatic revocations, TE/GE devised a contingency plan "to meet whatever application processing needs [are] presented."[25] The plan was to transfer backlogged applications from the Cincinnati Determinations office to EO Rulings and Agreement employees in Washington D.C.[26] TE/GE has not put this contingency plan into effect "[b]ecause we have not experienced timeliness issues processing the reinstatement cases."[27] TAS cases and the data cited above show otherwise — *that by every meaningful measure of taxpayer service, the burden on new and revoked EOs applying for exemption has increased significantly.*

22 TE/GE BPR FY 2012: Second Quarter 27 (May 23, 2012) *available at* http://tege.web.irs.gov/lib/my-resources/TEGE_BPR_2nd_Quarter_FY2012.pdf.

23 TAS Inventory Report, Year to Date Receipts by Primary Issue Code/Description Codes 160 and 460 for FY 2010 and FY 2012.

24 IRC § 7811(a) authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order if the National Taxpayer Advocate determines the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary. Treas. Reg. § 301.7811(a)(4)(ii) provides that "Significant hardship includes situations in which a system or procedure fails to operate as intended or fails to resolve the taxpayer's problem or dispute with the IRS. A significant hardship also includes, but is not limited to: (A) An immediate threat of adverse action; (B) A delay of more than 30 days in resolving taxpayer account problems; (C) The incurring by the taxpayer of significant costs (including fees for professional representation) if relief is not granted; or (D) Irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted."

25 National Taxpayer Advocate 2011 Annual Report to Congress 437, 447 (Status Update: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*, IRS Comments).

26 IRS response to TAS information request (Aug. 2, 2012).

27 *Id.*

TE/GE is not devising any new notices that might avert automatic revocations in the future, preferring to monitor whether the current notices are effective now that it has organizations' updated address information.[28] However, because more than 72,000 organizations that lost exempt status were covered by group exemption letters, TE/GE has concerns about the extent to which these organizations understand their filing obligations.[29] TE/GE is developing a questionnaire to send to a random sample of group ruling holders to learn more about how parent and subordinate organizations satisfy their reporting obligations.[30]

Applying for Exempt Status is Unnecessarily Burdensome

As the National Taxpayer Advocate has pointed out, Form 1023, a 12-page form requiring as many as eight schedules, is unnecessarily detailed for many small organizations.[31] The National Taxpayer Advocate has recommended that TE/GE develop a Form 1023-EZ for small organizations as an alternative to Form 1023, and make Form 1023 available as a web-based interactive product. The Advisory Committee on Tax Exempt and Government Entities recommended against creating a Form 1023-EZ, but proposed that the IRS redesign Form 1023 as a short core form with supplemental supporting schedules and offer more educational tools about the form.[32] The Advisory Committee noted that reformatting Form 1023 in this way would reduce the need for smaller organizations to respond to certain questions that currently appear, lessening the burden on them.[33] While the Advisory Committee's recommendations address the National Taxpayer Advocate's concerns about unnecessary burden and information-collection, we note that the success of any revised form will depend on the details of the new design. A redesigned form with interactive directions that asks plain-language questions and specifies the documents and schedules the applicant must attach would minimize errors and omissions and reduce taxpayer burden. TE/GE is responding to the Advisory Committee's recommendation by creating an interactive version of Form 1023, but it does not plan to revise or reformat it because "such revisions would require resources beyond Exempt Organizations."[34] The National Taxpayer Advocate finds this response inadequate in light of demonstrated need, and recommends

28 IRS response to TAS information request (Aug. 2, 2012).

29 *Id.* A group of organizations affiliated with a central organization may apply for recognition of exempt status as a group, rather than each organization applying individually. The IRS may recognize a group of organizations as exempt and issue one determination letter that applies to more than one organization. The filing requirements for the subordinates in the group remain the same, but the central organization may file annual group returns for those subordinate members of the group that, among other things, have the same accounting period as the central organization. *See* Treas. Reg. § 6033-2(d) and IRS Publication 4573, *Group Exemptions*.

30 *Id.*

31 National Taxpayer Advocate 2011 Annual Report to Congress 562 (Legislative Recommendation: *Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*).

32 IRS response to TAS information request (Aug. 2, 2012); Advisory Committee on Tax Exempt and Government Entities (ACT) Report of Recommendations *Exempt Organizations: Form 1023 – Updating It for the Future* 2, 30-34 (June 6, 2012), *available at* http://www.irs.gov/pub/irs-tege/tege_act_rpt11.pdf.

33 *Id.*

34 IRS responses to TAS information request (Aug. 2, Aug. 17, 2012). The projected release date for an interactive Form 1023 is not yet known, nor has a user fee been determined. The interactive form will not be filed electronically.

that TE/GE work with the National Taxpayer Advocate, the Advisory Committee, and the appropriate state agencies and IRS functions to revise and reformat Form 1023.[35]

TE/GE Erroneously Placed Organizations on the List of Revoked Organizations, with Severe Consequences for Some.

The decline in service to organizations requesting reinstatement of exempt status, coupled with the lack of administrative review, is particularly unfair to taxpayers that the IRS erroneously treated as no longer exempt. After the Treasury Inspector General for Tax Administration found that a programming problem existed, TE/GE identified more than 2,270 cases in which an organization was erroneously listed as having had its exempt status revoked, and 300 to 400 additional entities identified themselves as erroneously so listed.[36] The most common reason for the erroneous revocations was that IRS systems did not recognize subordinate organizations as part of a group return when the subordinates and the parent organizations had different accounting periods.[37] Upon discovering an erroneous revocation that appeared to be due to a systemic error, TE/GE researched whether other organizations were also erroneously treated as no longer exempt based on the same systemic condition. If so, TE/GE corrected their accounts as necessary, removed them from the revocation list, and notified them of the error. TE/GE worked with IRS Modernization & Information Technology Services to address programming errors.[38]

The IRS updates its records monthly, but if the IRS recognizes, even as soon as the day after a scheduled update, that it erroneously listed an organization as no longer exempt, the organization may not appear as exempt on IRS records for two months.[39] This can create serious problems for the organization, as some donors base contribution decisions exclusively on an organization's classification in IRS electronic records.[40] As the Chief Financial Officer of one organization erroneously placed on the list of revoked organizations noted,

35 IRM 1.1.23.5(4)(h) (Feb. 1, 2007) provides that to accomplish its mission, EO "Coordinates with state agencies and Director TE/GE Customer Account Services on the design of EO forms and instructions and on the processing of EO forms."

36 TIGTA, Ref. No. 2012-10-027, *Appropriate Actions Were Taken to Identify Thousands of Organizations Whose Tax-Exempt Status Had Been Automatically Revoked, but Improvements Are Needed* 9 (Mar. 30, 2012). See *ABA Meeting: Official Encourages Contact from EOs with Wrongly Revoked Exemptions*, Tax Notes Today (May 11, 2012), available at 2012 TNT 93-33, in which an IRS official noted "the IRS has made corrections for 300 to 400 organizations that came to the IRS and explained why the revocations were erroneous."

37 IRS response to TAS information request (Aug. 2, 2012). Other erroneous revocations occurred when IRS systems did not recognize EOs with more than one Employer Identification Number (EIN) that filed a return showing only one EIN; when IRS systems did not recognize, and therefore did not accept, an e-Postcard from organizations that had never previously filed a return or application for exempt status; when the IRS was unaware that state credit unions no longer had a filing obligation because they had become federally chartered; and when IRS systems had not been updated to reflect an IRS determination that the EO did not have a filing obligation, or the IRS erred in advising the organization that it did not have a filing obligation.

38 IRS response to TAS information request (Aug. 2, 2012).

39 See *Correction: Some EOs Seeking Reinstatement May Not Appear on IRS Website For Up to 2 Months*, Tax Notes Today (May 15, 2012), *available at* 2012 TNT 95-9.

40 TAS, Taxpayer Advocate Management Information System (TAMIS) Case File 272001. Despite the IRS's assertion that a letter from the IRS affirming the organization's exempt status is "good as gold" (see *ABA Meeting: Official Encourages Contact from EOs with Wrongly Revoked Exemptions*, Tax Notes Today (May 11, 2012), *available at* 2012 TNT 93-33), donors may not be able to integrate such a letter into their electronic grant making systems, which automatically consult IRS electronic records only.

> The action of our contributor in withholding their gift adversely impacts us in two ways: we don't have the gift, and the contributor may be asking 'What's wrong with [the organization] that the IRS pulled the plug on them?' The fact that we are ineligible to apply for grants whose filing deadlines will pass before our name is restored to the IRS website creates an irreparable harm to our organization.[41]

In addition, the IRS may initiate a compliance check, informing the organization that because its exemption was automatically revoked, it may no longer be eligible to sponsor an IRC § 403(b) pension plan.[42] State regulatory authorities may inform the organization that they are aware of the automatic revocation and remind the organization of possible liability under state law if it represents that donations are deductible when they are not.[43]

These consequences pose extreme hardship for organizations whose existence depends on their IRS list status. A process of administrative review might allow an organization to quickly resolve any errors and prevent it from being listed as no longer exempt, or at least minimize the period during which it is treated as having had its exempt status revoked.

CONCLUSION

In conclusion, the National Taxpayer Advocate preliminarily recommends that:

1. If TE/GE adopts the Advisory Committee's recommendation that it not develop a Form 1023-EZ, it should work with the National Taxpayer Advocate, the Advisory Committee, and appropriate state agencies and IRS functions to implement the committee's recommendations that it redesign Form 1023 to include a short core form with supplemental supporting schedules, and develop more educational tools about the form. The redesigned form should be interactive, have plain-language questions, and specify the documents and schedules the applicant needs to attach.
2. TE/GE should augment existing electronic databases with a smaller electronic file or "addendum" that can be updated more frequently than once a month.
3. TE/GE should provide for administrative review of an organization's claim that it was, or is about to be, erroneously treated as no longer tax exempt.
4. TE/GE should seek additional staffing for review of applications for exempt status and reinstatements and for phone assistance to bring its service at least back to pre-revocation levels if not better.

41 TAS, TAMIS Case File 5272001, email from taxpayer's Chief Executive Officer to Deputy Director of Communications, Office of Rep. Israel (Mar. 12, 2012), on file with TAS. When TAS asked the IRS what caused this organization to be erroneously treated as no longer exempt, the IRS responded, "The IRS system does not reflect that this organization was ever automatically revoked. However, the IRS system does show that the organization's account was updated to a status that indicates that the organization was no longer in business. Once notified by the organization, the status was corrected." IRS response to TAS information request (Aug. 2, 2012). We find it disturbing that the IRS could be unaware of what actually happened in this case.

42 TAS TAMIS Case File 5213829.

43 TAS TAMIS Case File 5240782.

IRS COMMENTS

Congress passed the Pension Protection Act in 2006, amending IRC § 6033. The law now requires most tax-exempt organizations to file an annual information return or notice with the IRS. For small organizations, the law imposed a reporting requirement (e-Postcard, or Form 990-N) for tax years beginning after December 31, 2006. The new law also provides for the automatic revocation of the tax-exempt status of any organization that does not file a required return or notice for three consecutive years. In addition, the law states that all organizations automatically revoked by operation of law "must apply in order to obtain reinstatement of such status regardless of whether such organization was originally required to make such an application."[44] Therefore, as required by the statute, automatically revoked organizations must file an application for exemption to have their tax-exempt status reinstated, just as any other organization seeking IRS recognition of tax-exempt status.

The IRS is proud of its implementation of Congress' mandate. Over several years, the IRS took unprecedented steps in bringing awareness of the provision to the exempt organizations community through targeted as well as general outreach. The IRS also provided small organizations additional time for filing after releasing a preliminary list of organizations for which we had not received a filing. Slightly larger organizations were also given an opportunity to come into compliance without losing their tax-exempt status. In addition, after the revocation list was released, the IRS provided a special transition process for smaller organizations to have their tax-exempt status reinstated. In the years building up to the imposition of the automatic revocation, and in this period following revocation, the IRS has continually taken steps to assist EOs, especially those that are smaller.

The IRS agrees with the National Taxpayer Advocate that it could be beneficial to taxpayers to redesign the Form 1023 as an electronic short core form with supplemental supporting schedules, as recommended by the Advisory Committee on Tax Exempt and Government Entities (ACT) in its report released in June 2012.[45] This type of total redesign would, however, require resources from many parts of the IRS, including information technology. Because the IRS must balance a number of competing needs, we cannot presently predict when we can undertake the full redesign. However, to more immediately address the issue, the IRS asked the ACT to suggest steps to assist taxpayers with the application process in the interim. In response, the ACT suggested that the IRS post previously developed educational information on the IRS website to assist applicants. The IRS is going one step further, and is in the process of incorporating that previously developed information into an interactive web-based version of the existing Form 1023 that applicants can prepare online and then print and send into the IRS for review. We expect to make the interactive form available during the next calendar year.

44 Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006).

45 Advisory Committee on Tax Exempt and Government Entities (ACT), *Report of Recommendations Exempt Organizations: Form 1023- Updating It for the Future 32* (June 6, 2012), *available at* http://www.irs.gov/pub/irs-tege/tege_act_rpt11.pdf.

The IRS understands that delayed notification of reinstatement can be a hardship for organizations that have been erroneously revoked. When the IRS determines that an organization has been erroneously revoked, it issues a letter advising the organization of the error, and this letter may be used by the organization to establish its tax-exempt status with donors, the public, or other government agencies.

The IRS also understands that organizations and their contributors often wish to use IRS's online resources, rather than a letter, to confirm tax-exempt status. For that reason, the IRS has been taking steps to increase the speed at which information about the tax-exempt status of organizations is updated on its publicly available resources. To provide the public with more timely information about the tax-exempt status of organizations, in January, 2011, the IRS began updating its publicly available online resources on a monthly rather than quarterly basis. Adding more frequent updates or creating a smaller electronic file or "addendum" would require additional programming and resources, which will have to be balanced with other competing IRS needs and systems limitations.

Under the PPA, automatic revocation of exemption occurs by operation of law. Because the IRS makes no determination regarding the automatic revocation, there is no IRS conclusion or determination to review. Automatic revocations are generated from data within the IRS BMF, which indicates the organizations that have failed to meet their filing requirements for three consecutive years. When passing the PPA, Congress recognized that the taxpayer information in the IRS systems may no longer be correct and that the new filing requirements could assist the IRS in updating this information and ensuring the accuracy of IRS systems going forward. Because the IRS also recognizes that automated systems can produce mistaken results, either because of programming issues or because of faulty data, the IRS has told organizations to notify the IRS if they believe they have been erroneously included on the Automatic Revocation List. The IRS will correct any mistakes.[46]

Preliminarily, approximately 450,000 organizations have been automatically revoked for failing to file an annual notice or return for three consecutive years. As of November 5, 2012, the IRS had received approximately 27,000 applications for reinstatement of tax-exempt status from automatically revoked organizations (approximately six percent of revoked organizations), and had closed approximately 17,000 of those applications (approximately 63 percent of requested reinstatements).

The IRS appreciates the importance of processing applications for exemption in a timely manner and providing quality customer service at our call sites. We have initiated a

46 *See Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions*, at http://www.irs.gov/Charities-&-Non-Profits/Automatic-Exemption-Revocation-for-Non-Filing:-Frequently-Asked-Questions-2. The answer to Frequently Asked Question 10, ("If an organization on the Auto-Revocation List has documentation that it met its filing requirement for one or more years during the three-year period, what should it do?") is: "An organization possessing documentation (an IRS receipt for a filed return, for example) that shows it has not failed to file for three consecutive years should contact Customer Account Services, or send the documentation directly to the Exempt Organizations Account Unit." The answer to Frequently Asked Question 11, ("If an organization on the Auto-Revocation List has a letter from the IRS stating that it does not have an annual filing requirement, what should it do?") is: "An organization with a letter from the IRS stating that it does not have an annual filing requirement should contact Customer Account Services."

number of efficiencies to improve the timeliness of our review of applications for tax-exempt status. Rather than assigning all cases to an agent for development, we put in place a screening system to fast-track those applications that are complete and require little or no further development.

This process has dramatically decreased the number of cases that need to be assigned for full development. For example, in FY 2012, 70 percent of all application cases were reviewed and closed within approximately 120 days during this initial technical screening process. Organizations whose applications cannot be completed through technical screening are sent letters informing them that more development of their application is needed.

To give applicants a sense of how long the wait could be before their application is assigned to a reviewer, we post on the IRS website ("Where's My Application") the date of applications currently being assigned. In an abundance of caution, however, the date given on the website is the oldest date of applications awaiting assignment. Most applications requiring full development are assigned well before that date, and the average wait time for full development applications at this time is roughly five months from the date we receive the application. We know the web page has created some confusion and we are in the process of revising the "Where's My Application" web page and letters to applicants to provide better information on wait times.

In addition, we continue to improve our process for reviewing applications and provide more education to applicants so more applications may be reviewed and closed during the screening process. We are confident that the new interactive Form 1023 will help in this respect.

To provide a high level of assistance to the ever-increasing number and complexities of tax-exempt organizations, while using our resources most effectively, the IRS takes a balanced approach towards customer service. First, the IRS website provides numerous resources to exempt organizations to assist them with all compliance issues. For automatic revocation specifically, we have developed "Frequently Asked Questions" targeted topic pages and tax tips directed towards both organizations and their contributors, to answer most auto-revocation scenarios. We encourage organizations to look to the website first to find information regarding their situations. Because website availability is not limited by work hours or staffing, it is a good way for organizations to instantly get the information they need at their convenience.

Second, the IRS recognizes that there may be some questions/concerns that cannot be answered by the website. For those less usual circumstances, call site staff, who are trained and dedicated solely to exempt organization issues, are available to provide assistance. In some cases, Rulings and Agreements staff also provide technical support to individuals on revocation/reinstatement issues. Unfortunately, people do not always go to the website first to find the answers to their questions, but instead go directly to the call site, which can lead to longer wait times for all callers. We will continue to improve our educational efforts to encourage customers to review the website for their questions before contacting the call site.

The IRS remains committed to ensuring a fair and effective implementation of section 1223 of the PPA with the automatic revocation and reinstatement process created by section 1223 of the PPA. Despite the increase in applications due to requests for reinstatement, the IRS has maintained a high level of service to organizations and the public, and will continue look for additional ways to provide quality assistance.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate commends TE/GE for developing an interactive version of the present Form 1023, which would be an improvement, but we retain our recommendation that TE/GE heed the recommendation of its Advisory Committee to redesign the form in ways that will significantly lessen the burden on taxpayers.[47] Without a more definitive commitment, it is not clear that TE/GE would actually undertake the redesign even if resources were readily available. Similarly, TE/GE does not articulate any objection, beyond resource considerations, to updating its electronic database more frequently than once a month, but doing so does not appear to be a priority. We therefore retain our recommendation that TE/GE provide these updates. We note that the tax exempt sector fulfills an essential role in the charitable, civic, scientific, and educational sectors of our economy, among others, and the IRS's failure to immediately update its records with respect to eligible charities unnecessarily harms these entities and undermines public policy.[48]

Finally, we retain our recommendation that TE/GE make administrative review available, a proposal that TE/GE rejects on the grounds that revocations under PPA occur automatically and thus there is no "determination" to review. At the same time, TE/GE acknowledges that inaccurate automatic revocations can result from programming errors or faulty data. Nothing in PPA prevents or prohibits TE/GE from establishing a regularized procedure for taxpayers to alert the IRS about an erroneous revocation. TE/GE's ad hoc approach of correcting mistakes that single taxpayers bring to its attention is not a substitute for publicly available, established procedures for requesting review, which standards of tax administration and administrative procedure require.

47 The "interactive web-based version of the existing Form 1023 that applicants can prepare online and then print and send into the IRS for review," referred to in the IRS's response, sounds very similar to Cyber Assistant, a web-based software program the IRS announced would be available in 2010, and an initiative the National Taxpayer Advocate supported. *See* National Taxpayer Advocate 2011 Annual Report to Congress 562 (Legislative Recommendation: *Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*). The release of Cyber Assistant was delayed until further notice. IRM 3.45.1.11.6.2 (Jan. 1, 2012).

48 The Independent Sector, a nonpartisan coalition of approximately 600 organizations founded in 1980, reports that the nonprofit sector provides 5.5 percent of the nation's entire gross domestic product or $751 billion worth of output. Moreover, "[i]n 2009, nonprofits employed 13.5 million individuals, or approximately 10% of the country's workforce. To provide a comparison, more people work in the sector than in the finance industry, including insurance and real estate, combined." Additionally, "[e]mployees of nonprofit organizations account for 9% of wages paid in the U.S. in 2009, and the nonprofit sector paid $668 billion in wages and benefits to its employees." (Fn refs. omitted). The Economic Sector, *The Sector's Economic Impact, available at* http://www.independentsector.org/economic_role.

The National Taxpayer Advocate is encouraged by TE/GE's initiatives to improve the efficiency with which it processes applications for exempt status. However, TE/GE reports that its new screening procedures reduce the number of days it takes to *review and close* some cases. It is not clear whether this reduced time includes the number of days the IRS has the application but has not begun to review it. Moreover, the reduced processing time for cases that need *little or no development* is 120 days — four months. At any rate, in spite of its new procedures, TE/GE's June, 2012, volume of open inventory was 36,034 cases, compared to the June, 2011, volume of 17,451 cases, so while taxpayers might have been even worse off without the new procedures, the sheer volume of applications may be outpacing the gains in efficiency.[49]

Recommendations

To improve the automatic revocation and reinstatement process, and to lessen the burden on taxpayers seeking recognition of exempt status, the National Taxpayer Advocate recommends that:

1. If TE/GE adopts the Advisory Committee's recommendation that it not develop a Form 1023-EZ, it should work with the National Taxpayer Advocate, the Advisory Committee, and appropriate state agencies and IRS functions to implement the committee's recommendations that it redesign Form 1023 to include a short core form with supplemental supporting schedules, and develop more educational tools about the form. The redesigned form should be interactive, have plain-language questions, and specify the documents and schedules the applicant needs to attach.
2. TE/GE should augment existing electronic databases with a smaller electronic file or "addendum" that can be updated more frequently than once a month.
3. TE/GE should provide for administrative review of an organization's claim that it was, or is about to be, erroneously treated as no longer tax exempt.
4. TE/GE should seek additional staffing for review of applications for exempt status and reinstatements, and for phone assistance to bring its service at least back to pre-revocation levels if not better.

49 TE/GE BPR FY 2012: Third Quarter 27 (Aug. 16, 2012) *available at* http://tege.web.irs.gov/article.asp?category=resources&title=reports-budget-it&path=/my-resources/reports-budget-it.

Introduction to Most Serious Problems: The IRS Must Confront Challenges to Delivering High Quality Taxpayer Service in the Twenty-First Century

It is, of course, essential to the success of such a program that Bureau personnel be indoctrinated with an attitude of complete objectivity toward the taxpayers' obligations to the Government. They must, in effect, represent both the taxpayer and the Government with the sole purpose in mind of obtaining a correct determination of the tax under the prevailing law and its current interpretation — the correct tax to which the Government is entitled, but not $1 more. A full-fledged and vastly expanded program of taxpayer assistance in the preparation of returns would drastically reduce audit requirements and in the long run be productive of substantially increased revenue.[1]

OVERVIEW

The IRS has entered the twenty-first century after evolving from an organization of local collection districts into a centralized nationwide processing operation.[2] Yet concerns articulated by congressional experts shortly after enactment of the mass income tax, as quoted above, persist today. Information technology has facilitated mass production under tight budgetary constraints at a cost of individualized service. This section surveys taxpayer service through eight Most Serious Problems (MSPs), four of which concern means of communication or serving taxpayers, including telephone, correspondence, electronic technology, face-to-face and video-conferencing. Another four MSPs address various sectors, including tax professionals as well as low income, small business, and international taxpayers. Thus, a matrix of technological channels and taxpayer preferences confronts the IRS, which must use limited resources to deliver personal service where necessary. Internally, the IRS needs to consider potential repercussions to taxpayers from telework practices. Some channels that appear expensive at first may turn out to be the most effective for certain taxpayer populations or issues, potentially proving to be efficient in the end.

BACKGROUND

The IRS has to meet taxpayers where they are. All taxpayers live in geographic locations where homogeneity at different levels, including tax compliance behavior, delineates cultural regions.[3] Geography is everywhere, and IRS efforts to encompass all taxpayers with a single apparatus cannot avoid regional differences. It would be better to confront regional and other differences directly.

Against inherent taxpayer diversity, mass production has been an inevitable alternative to processing a growing return population. Historically, mass production flourished

1 Jt. Comm. on Int. Rev. Tax'n, Investigation of the Bureau of Int. Rev. (Washington, DC: Gov't Printing Office, 1948) 37.

2 *See* National Taxpayer Advocate 2011 Annual Report to Congress, Vol. 2, § 1 at 1 (Research Study: *From Tax Collector to Fiscal Automaton: Demographic History of Federal Income Tax Administration*, 1913-2011).

3 *See generally* Mona Domosh *et al*. The Human Mosaic: A Thematic Introduction to Cultural Geography 12th ed. (NY: W.H. Freeman & Co., 2012).

under a model of scientific management famously articulated by the engineer Frederick Winslow Taylor, whereby an office "divided skills into a sequence of simple procedures to be taught to workers and monitored by management."[4] In 1911, Taylor's regime focused on individual output: "when accurate records are kept of the amount of work done by each man and of his efficiency, and then each man's wages are raised as he improves, and those who fail to rise to a certain standard are discharged ..."[5] In 1925, the IRS established an "Efficiency-Record Section" for personnel functions as well as training of income tax auditors and technicians.[6] Even today, any particular IRS employee may develop efficiency in one skill or program, but few employees (mostly higher-level managers) know the tax system as a whole. As a result, an IRS employee may not realize how a program affects a taxpayer overall. In the words of a critic, Taylorism requires a clerk to "'forget' or not think about the intellectual content of the text he is reproducing."[7] While Taylor's management science was an advance when he introduced it, in the twenty-first century it may be time for something more holistic.[8]

Nevertheless, the pressure to operate efficiently cannot be overlooked, especially when the IRS operates under resource constraints that may be disproportionate in the developed world. Of 34 countries listed by the Organisation for Economic Co-operation & Development, only four have higher ratios than the U.S. of citizens to tax staff. Taxpayer workload in the face of limited resources puts pressure on IRS efficiency.

4 *A Short History of the Birth & Growth of the American Office*, Carbons to Computers, Smithsonian Inst. (Washington, DC: 1998); see Frederick W. Taylor, The Principles of Scientific Management (NY: Harper Bros., 1911), ch. 2, stating: "Under the old type of management success depends almost entirely upon getting the 'initiative' of the workmen, and it is indeed a rare case in which this initiative is really attained. Under scientific management the 'initiative' of the workmen (that is, their hard work, their good-will, and their ingenuity) is obtained with absolute uniformity and to a greater extent than is possible under the old system ... The managers assume ... the burden of gathering together all of the traditional knowledge which in the past has been possessed by the workmen and then of classifying, tabulating, and reducing this knowledge to rules, laws, and formulae."

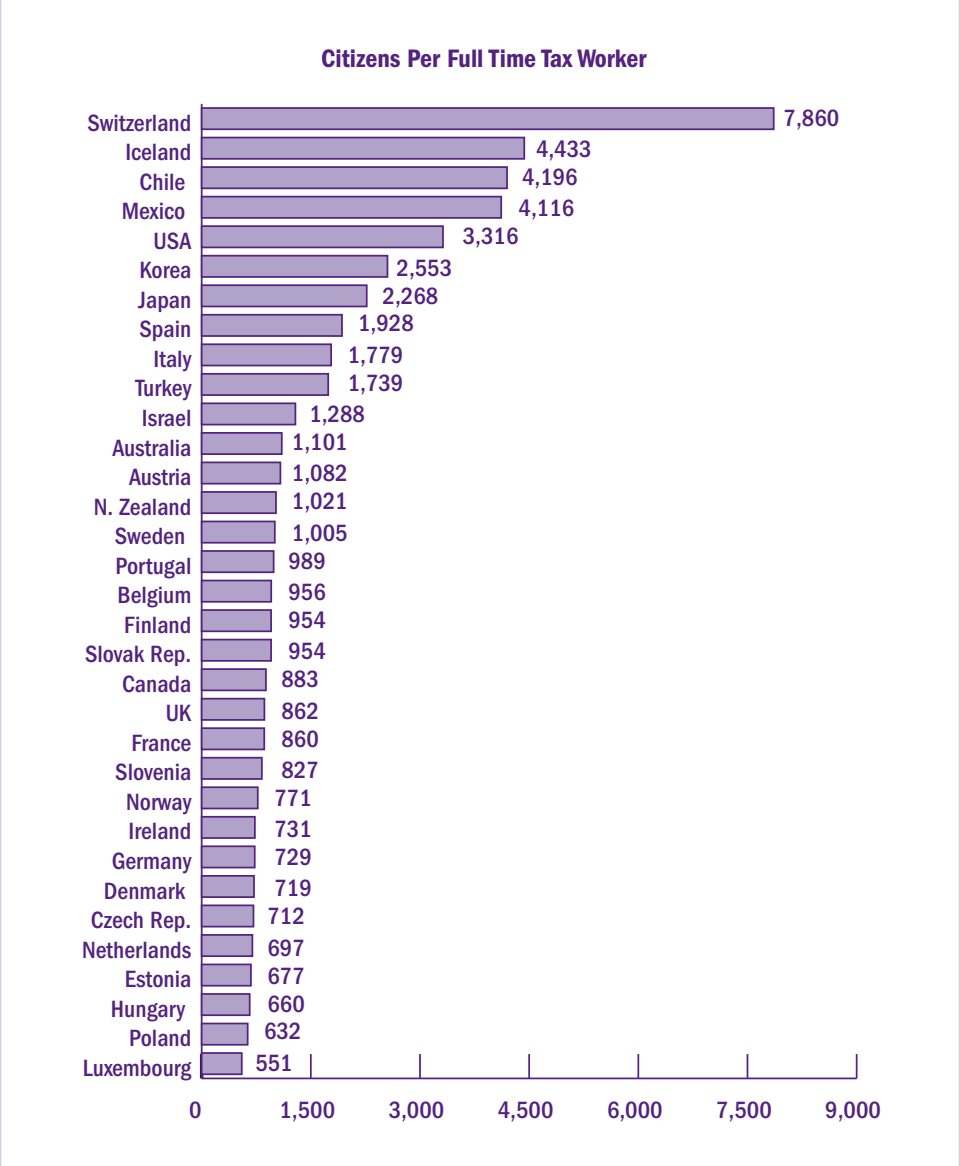
5 Taylor, Principles of Scientific Management, ch.1 (quoting from presentation to Amer. Soc'y of Mechanical Engineers, June 1903). Taylor was a colleague of time & motion efficiency experts Frank B. & Lillian M. Gilbreth, whose family was portrayed in a book and movie, *Cheaper by the Dozen* (1950).

6 Subsequently, the Efficiency-Record Sec. was merged into a Personnel Div'n. *See* IRS Pub. 1694, *Historical Fact Book: A Chronology, 1646-1992* at 99, 109, 114; Comm'r of Int. Rev., Ann'l Rep't (1920) at 13, (1922) at 11, (1924) at 7.

7 *Taylorism and the Mechanization of the Worker*, Antonio Gramsci Reader: Selected Writings, 1916-1935, ed. David Forgacs (NY: Schocken Books, 1988).

8 *See* Robert Kanigel, *Taylor-made*, 37 The Sciences 18 (NY Acad. of Sci. 1997); Michael Maccoby, The Leaders We Need (Boston: Harv. Business School Press, 2007) 22-23.

FIGURE 1.1, Ratio of Citizens to Tax Staff by Country[9]



9 The ratio is number of citizens per full-time tax employee. In Greece, Iceland, and Chile, data are unavailable or incomplete. In Switzerland, federal tax staff administer only the value-added tax (VAT) while local personnel (not in table) administer personal and corporate income tax. In Mexico, the tax system is smaller than in most other OECD countries. In the USA, there is no federal VAT. *See* OECD Forum on Tax Admin. Tax Administration in OECD and Selected Non-OECD Countries: Comp. Info. Ss. (2010) Table 21, ¶¶13-22 at 134-37.

ISSUES

The IRS Has an Information-Gathering Apparatus.

The IRS has ways to gather information about taxpayers' needs and communicate with them about the services it offers. In particular, the IRS has research and communication functions embedded in the National Office as well as the Operating Divisions, highlights of which are summarized below. The Taxpayer Advocate Service (TAS) has parallel functions.

In the National Office, the Research, Analysis & Statistics division contains an Office of Program Evaluation and Risk Analysis (OPERA). Founded by Commissioner Charles Rossotti in the aftermath of the IRS Restructuring & Reform Act of 1998 OPERA includes, approximately 40 analysts, economists, statisticians, and researchers who help the IRS determine resource allocations, mitigate potential risks, and develop plans and other program management capabilities.[10] Also in Washington, DC, the National Public Liaison (NPL) within the headquarters Communication & Liaison (C&L) function, among other activities, coordinates professional seminars called Nationwide Tax Forums, as well as two Federal Advisory Committees.[11]

The Wage & Investment (W&I) operating division, with individual taxpayers in its customer base, has a Research & Analysis (R&A) function comprising seven groups focusing on:

- Taxpayer Needs, Preferences & Burden;
- Electronic Tax Administration Support & Self-Preparer Taxpayer Studies;
- Relationship of Service & Compliance;
- IRS Partner Needs & Preferences;
- Refundable Credits;
- Knowledge Infrastructure; and
- Survey Administration & Analysis.[12]

In addition to a divisional C&L office, W&I has a Customer Assistance, Relationships & Education (CARE) function that includes Stakeholder Partnerships, Education & Communication (SPEC), which divides the country into four areas, each with about 15 posts of duty, where employees assist taxpayers in fulfilling their responsibilities.[13] CARE also houses Media & Publications, which produces the tax forms and publications that, as a practical matter, are the face of the IRS for many taxpayers.

10 http://opera.web.irs.gov/about.html (last visited Aug. 30, 2012).

11 http://irweb.irs.gov/AboutIRS/bu/cl/npl/default.aspx (last visited Aug. 30, 2012).

12 http://win.web.irs.gov/Research/WIRA_webpage.htm (last visited Dec. 13, 2012).

13 http://win.web.irs.gov/spec/docs/SPEC_Chart_FO.pdf (last visited Aug. 30, 2012).

In the Small Business/Self-Employed (SB/SE) operating division, a half-dozen Research groups identify economic and demographic trends.[14] Techniques include:

- Trend analysis of filing, payment, and reporting patterns;
- Market research;
- Impact measurement; and
- Development and prioritization of alternative methods of enhancing voluntary compliance.

For example, SB/SE Research generates statistics in support of financial or procedural guidance (such as those needed to establish and support standards like Allowable Living Expenses for bankruptcy administration).[15] Additionally, SB/SE Stakeholder Liaison focuses on national and local engagement of the payroll and practitioner community and stakeholder organizations to disseminate information about IRS policies, practices, and procedures to ensure compliance with the tax laws, both by voluntary means and through enforcement programs.[16]

In the Large Business & International (LB&I) operating division, a Planning, Analysis, Inventory & Research (PAIR) function includes, among others, a Workload Identification office, which has a few branches of almost ten employees each to:

- Conduct cross-industry research on compliance risk; link with the Pre-Filing Technical Group;
- Leverage academic and other external research to identify emerging issues and trends in tax administration and compliance; and
- Develop return scoring models and filters for compliance risk.[17]

In addition, a C&L function offers Communications Consulting Services for notifying Revenue Agents about significant tax law changes and other internal or external messages.[18]

Finally, TAS has some half-dozen R&A staff who produce studies that:

- Review IRS interactions with taxpayers and suggest ways to improve IRS communications;
- Evaluate audit, collection, and other IRS enforcement programs to protect taxpayer rights and minimize taxpayer burden;
- Summarize taxpayer statistics annually for each congressional district;

14 http://mysbse.web.irs.gov/AboutSBSE/Research/default.aspx (last visited Aug. 30, 2012).

15 *Id.*

16 http://mysbse.web.irs.gov/AboutSBSE/CLD/aboutsl/default.aspx (last visited Aug. 30, 2012).

17 http://lmsb.irs.gov/hq/srp/RWI_Contacts/Research_Teams/Team_1.asp (last visited Aug. 30, 2012).

18 http://lmsb.irs.gov/hq/cl/new_communications/communications_guidance.asp (last visited Aug. 30, 2012).

- Explore taxpayers' service needs;
- Focus on Earned Income Tax Credit (EITC) taxpayers;
- Identify characteristics of TAS customers and factors that affect TAS's workload; and
- Address factors that influence taxpayers and preparers to comply with the tax laws.[19]

Meanwhile, about 20 TAS C&L employees are charged with making TAS a nationally and locally known organization.[20]

In sum, national and divisional components of the IRS have research and communication functions in part to understand and respond to taxpayer needs. These parallel functions are targeted to each component's customer base. While there is coordination through a Servicewide Research Council (SRC) that "serves as a forum for sharing information, coordinating crosscutting actions and resolving procedural issues that affect the execution of research and analysis across operating divisions," SRC "will not supplant the authority and accountability, which resides in the research organizations, embedded in the operating divisions and the functions."[21] In any case, the multi-level research and communication apparatus should leave no doubt about the importance of information gathering and exchange between the IRS and taxpayers. The question may be how to interpret and apply information.[22]

Taxpayer Needs Vary by Sector.

Taxpayer needs vary by sector as well as by inherent geographic variations. The MSPs that follow discuss needs of some salient sectors. In the case of tax professionals, return preparers, or other advisors, IRS errors and omissions in recognizing their powers of attorney or similar authorizations harm not only the professional but also the client.[23] For low income and small business populations, IRS representatives such as Stakeholder Liaison discussed in an MSP below face a historic low in staffing that paradoxically coincides with increases in demand for assistance.[24]

Other taxpayer needs relate to consumer preferences susceptible to market research by the research functions described above. For example, using "conjoint" techniques that allow researchers to deduce preferences from respondents' choices among an array of options, the IRS has surveyed preferences of randomly recruited taxpayers among seven telephonic, online, or postal media — not including in-person channels such as Taxpayer

19 http://tas.web.irs.gov/res/default.aspx (last visited Aug. 30, 2012).

20 http://tas.web.irs.gov/Comm/outreach/default.aspx (last visited Aug. 30, 2012).

21 SRC Charter (Mar. 14, 2001).

22 For previous commentary on aspects of IRS research, see National Taxpayer Advocate 2007 Annual Report to Congress 156 (Most Serious Problem: *Taxpayer Service and Behavioral Research*).

23 See Most Serious Problem: *IRS Processing Flaws and Service Delays Continue to Undermine Fundamental Taxpayer Rights to Representation, infra*.

24 See Most Serious Problem: *The IRS Is Substantially Reducing both the Amount and Scope of its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of its Remaining Outreach Activities, Thereby Risking Increased Noncompliance, infra.*

Assistance Centers (TACs) — relating to seven generic service tasks (rather than specific account resolutions).[25] From 2006 to 2011, preferences shifted slightly away from a toll-free telephone Customer Service Representative toward online service. In 2011, the online interactive tool was the most preferred channel for all needs (except getting a form or publication, for which printing, rather than ordering hard copy, from the website was the preferred channel). For newer media, the results showed that taxpayers prefer social media, which offer general information but not resolution of specific problems, at lower rates than more established channels. Similarly, smartphone owners prefer these devices, especially for "getting the status of a transaction," at higher rates than the general population. Consequently, the researchers recommended that the IRS investigate the possibility of developing smartphone apps for checking the status of a tax transaction and using social media accounts to disseminate information about how to obtain a prior year return, and about which credits and deductions may be available. This "conjoint" study is exemplary of research on taxpayer preferences, given that the study's scope was the general population, rather than any particular sector.[26]

Research Can Prioritize Service Initiatives.

Other research focuses on preferences of certain taxpayer sectors. For example, some sectors are less likely than others to use the Internet.[27] Thus, the effect of constraints on face-to-face or similar services is not neutral with respect to taxpayer populations who prefer those channels.

As discussed in an MSP below, W&I and TAS have partnered on the Service Priorities Project to develop a ranking methodology that will take taxpayer preference into account.[28] The goal of the Project, which will use existing data while identifying data gaps, is to value each type of service from both the taxpayer and IRS perspectives. The Project will facilitate resource allocation decisions based on highest-valued services in the face of budget or staffing constraints.

Current Service Approaches May Not Meet Taxpayer Needs.

Merely identifying taxpayer needs and preferences may not mean that the IRS meets them. Given the expense of walk-in sites, the IRS often channels taxpayers into telephone or Internet service, where they may be underserved. Unfortunately, "walk-in" site is not

25 This paragraph summarizes IRS W&I R&A Group 2, *T[axpayer] A[ssistance] B[lueprint] Conjoint Update*, Project No. 2-10-09-S-058 (Feb. 2012) 2, 3-4 & 7. The tasks were: (1) getting a form or publication; (2) getting information about a notice you received from the IRS; (3) getting assistance determining tax credits and/or deductions you may be able to take on your tax return; (4) getting prior year return information; (5) making a payment or setting up a payment plan; (6) checking the status of a transaction; and (7) getting help making tax-related calculations.

26 Another limitation was that the methodology assumed complete awareness, availability, and information relating to service channels. *See TAB Conjoint Update*, Appdx. A at 14.

27 *See* National Taxpayer Advocate 2011 Annual Report to Congress 273, 279 (Introduction to Diversity Issues: *The IRS Should Do More to Accommodate Changing Taxpayer Demographics*) (citing data indicating that low income, less educated, minority, elderly, disabled, or rural populations were less likely than others to use the Internet).

28 *See* Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra.*

only a name but is now a limitation, since TACs no longer schedule certain appointments, instead offering service on a first-come, first-served basis.[29] Even if taxpayers use the phone instead, the IRS simply fails to answer more than three out of ten calls, potentially leading to unnecessary audits or submission of incomplete documentation, drawing out the duration of a case.[30] Resource constraints demand creative solutions.

Where the IRS leverages technology for efficiency gains, it may neglect taxpayer needs. In the case of telecommuting, the IRS may save the cost of office space by allowing employees to work at home despite information security risks. While telecommuting affords flexibility, promoted by both private employers and the government, customer impact remains a question. In the case of the IRS, telecommuting may affect taxpayer rights, especially privacy rights. Different statutes, with underlying guidance, set forth telework goals and taxpayer privacy rights.[31] Even if computer connections are secure, it may be impracticable to conceal tax return information from household members or neighbors visiting when the information is laid out in the flexible workplace at home. An option could be to allow taxpayers to consent to access of their return information by teleworking IRS employees, with the exception of Revenue Officers, Revenue Agents, or others whose job descriptions require working outside of the office. As of now, the rhetoric of telework omits customer impact, lacking a mechanism to assess and accommodate taxpayer preferences.

In short, current approaches effectively may ignore taxpayer needs. In some cases, cost may appear prohibitive. In other cases, taxpayers may not even be aware of potential risks surrounding IRS practices. In either case, the IRS should accommodate taxpayer needs and preferences both as a matter of principle and as a matter of encouraging compliance.

Taxpayer Diversity in the Face of Resource Constraints Calls for Innovation.

While resource constraints may be the primary concern, cost-effective innovations could yield improvements in taxpayer service. For example, at least for the Internet-savvy, a potential solution would be more self-service Web tools such as the popular "Where's My Refund?" application, as recognized by the IRS research described above. For small businesses, TAS has developed a Small Business Health Care Tax Credit Estimator to help plan for benefits available under the Affordable Care Act. For low income taxpayers, various needs could be met by a return-free or at least pre-populated filing system and a tax refund

29 *See* Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra.*

30 For FY 2012, IRS toll-free assistors answered 30.8 million of 107.8 million calls, a 67.6-percent Level of Service, with a 16.7-minute Average Speed of Answer. *See* IRS Enterprise Snapshot Rep't (Sept. 29, 2012); *see also* Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2012-40-036, *Interim Results of the 2012 Filing Season* (Mar. 30, 2012); Most Serious Problem: *The IRS Telephone and Correspondence Services Have Deteriorated over the Last Decade and Must Improve to Meet Taxpayer Needs, infra.*

31 *See* Dep't of Transp. & Related Agencies Appropriations, 2001, Pub. L. No. 106-346, 114 Stat. 1356A-36, § 359 (Oct. 23, 2000); Telework Enhancement Act of 2010, 5 USC § 6502(b)(4)(B); OMB Memo. M-11-27 (Jul. 15, 2011); IRM 6.800.2 (June 2, 2010); IRC § 6103.

debit card.[32] All taxpayers would benefit from a free e-filing portal.[33] For international taxpayers, lack of service could be mitigated by guidance on murky tax law questions.[34] Technological or other services could help these sectors help themselves.

The historic trend in tax administration has been away from personal service toward automation, which may be most effective for uniform provisions. Yet the tax Code has become more complex rather than more uniform. Given these inconsistent trends, an emerging option may be to use social and electronic technology to help taxpayers help themselves to unique options. As mentioned, automatic generation of taxpayer information as in the case of returns pre-populated by third-party information reports can give each taxpayer an individualized starting point. Web tools and smartphone applications such as those suggested by IRS research would further enable computer-savvy taxpayers to make transactions of their choosing.

A comparable mechanism could be self-service kiosks as now offered by retail establishments, automatic teller machines (ATMs), and even the Post Office. For relatively simple transactions, self-service can be more efficient. For more complex transactions, customer assistance may be necessary. Experts have cautioned that "coordinated human interactions are essential for the successful operation of retail kiosks."[35] This may be because kiosks are a form of "performance support technology [that] is quite distinct from automation. By definition, performance support technology is designed to support a human in accomplishing a task, not replace a human."[36] Kiosks or similar technology could allow the IRS to leverage staff as long as they can meet taxpayer needs, but if a complex transaction takes too long, a kiosk such as an ATM may "time out," leaving the customer to go to the teller anyway.[37] Successful use of self-service kiosks requires dedicated staff.[38]

The IRS has "kiosks in 37 Taxpayer Assistance Centers (TACs) where individuals can perform a wide variety of tasks, including filing a return, printing forms, and obtaining transcripts."[39] Experience has shown that taxpayers may walk into a TAC "expecting someone to complete their return, only to be told that they must take the keyboard and input

32 *See* Most Serious Problem: *A Proactive Approach to Developing a Government-Issued Debit Card to Receive Tax Refunds Will Benefit Unbanked Taxpayers, infra*.

33 *See* Most Serious Problem: *The IRS Has Failed to Make Free Return Preparation and Free Electronic Filing Available to all Individual Taxpayers, infra.*

34 *See* Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs, infra.*

35 Hira Cho & Susan Fiorito, *Self-Service Technology in Retailing: The Case of Retail Kiosks*, 1 Symphonya: Emerging Issues in Mgmt. 43, 45 (Univ. of Milan, 2010).

36 Thomas Cavanagh, *The Kiosk Culture: Reconciling the Performance Support Paradox in the Postmodern Age of Machines* (Ph.D. diss., Univ. of Central Fla., 2006) 10.

37 Cavanagh, *Kiosk Culture* at 84, citing Regina Colonia-Willner, Self-Service Systems: *New Methodology Reveals Customer Real-Time Actions During Merger,* 20 Computers in Human Behavior 243 (2004).

38 In November, 2010, a TAS delegation observed successful staffed kiosk use in facilities of the internal revenue service of Chile in Santiago.

39 IRS SPEC, *Facilitated Self Assistance [FSA] Reference Manual for 2013 Filing Season* 5 (Oct. 15, 2012).

their information" which can "lead to a perception of "'bait-and-switch'."[40] Consequently, "education about the options" may be as essential as staff assistance.[41]

Likewise, video-conferencing technology, if strategically deployed, may facilitate effective virtual service delivery (VSD) for taxpayers and enforcement functions.[42] For example, VSD may enable taxpayers and examiners to see one another as people when before they would have merely corresponded by mail. While technology in itself may not be the solution, a thoughtful combination of human effort with technological support can help.

FOR BETTER SERVICE, EVERY EMPLOYEE NEEDS TO KNOW HOW HIS OR HER WORK FITS INTO THE IRS MISSION.

Resource constraints are squeezing taxpayer service to a disproportionate extent, although enforcement efforts proceed. As discussed in an MSP below, international taxpayers feel pursued by enforcement initiatives even where certain rules remain unclear. Underserved groups continue to have needs, although certain innovations, like an e-filing portal, could address at least some of them. While creative solutions could come from creative thinking, the following parameters may help.

Like all populations, taxpayers are innately diverse on multiple dimensions, one of which is geographic diversity, particularly in a large country like the U.S.[43] Conversely, various regions contain cultures with an observable degree of internal consistency. Even in the high-technology industry, which is most likely to be adept at telecommunication, professionals gravitate toward local centers like Silicon Valley.[44] Like-minded people naturally form geographic communities.[45] By confronting cultural geography, along with other taxpayer sectors, through market segmentation or similar research techniques, the IRS could achieve an appreciable degree of targeting within cost-conscious service initiatives.[46] For instance, an MSP addressing stakeholder needs recommends the allocation of reduced liaison staffing to geographic areas or population strata that demonstrate the most critical needs.

The model of a locally centered occupational community may be helpful in rethinking management science. A hierarchical and specialized division of labor, in which clerical positions remain "permanently subordinated," may be characteristic of work and business

40 IRS SPEC, *Facilitated Self Assistance [FSA] Reference Manual for 2013 Filing Season 8* (Oct. 15, 2012).

41 *Id*.

42 *See* Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra; see also* Virtual Face-to-Face Audits: A prescription for curing the IRS's ailing correspondence examination process, http://www.taxpayeradvocate.irs.gov/Blog/virtual-face-to-face-audits (last visited Oct. 19, 2012).

43 *See generally* Wilbur Zelinsky, Cultural Geography of the U.S. (Prentice Hall, 1973).

44 *See* Edw. Glaeser, Triumph of the City (NY: Penguin Press, 2011).

45 On local culture, *see* Clifford Geertz, *Fact & Law in Comparative Perspective,* Local Knowledge: Further Essays in Interpretive Anthropology (N.Y.: Basic Books, 1983) (originally delivered as Storrs Lectures, Yale Law School, 1981).

46 On market segmentation, *see, e.g.*, Dennis Adcock *et al.*, Marketing: Principles & Practice 4th ed. (Prentice Hall, 2001).

in industrial and post-industrial societies.[47] At the same time, work would be less alienating where employees are better integrated into the office community both geographically or architecturally and substantively. In the past couple of decades, a trend toward "open" floor plans with cubicle dividers rather than office walls may have reflected, at least in part, an ideal of integration.[48] By contrast, telecommuting from home or other remote locations could isolate employees.

To train managers, the IRS has analyzed its organizational characteristics in terms of a well-known typology. According to the IRS: "In the type world of the Myers-Briggs Type Indicator (MBTI), the IRS is an ISTJ organization."[49] ISTJ refers to Introverted, Sensing, Thinking, and Judging, as opposed to Extroverted, Intuitive, Feeling, or Perceiving. The strength of ISTJ employees is "providing their own services or products... They are very reliable when it comes to getting details right." On the other hand, "[t]hey can lose contact with their constituency." By the same token, an ISTJ "organization is likely to be closed to outsiders... it is often difficult for anyone but an insider to spot internal problems at an early stage." Efficient yet detailed production is consistent with old-fashioned scientific management. Nevertheless, tax administration now demands contact with a constituency that has diversified over time. Telework or other technological approaches that increase isolation of employees who tend to be introverted and judgmental rather than extroverted and perceptive does not bode well for taxpayers who need help.

Connections between stovepiped functions and functionaries potentially could be forged through the multiple channels potentially available, such as Office Communicator and social media. In the case of TAS, all-employee conferences and other training sessions have fostered an understanding of the working of the whole organization among all employees, including clerical staff. Whatever the mechanism, the goal would be to inform each employee, no matter how small a cog in the bureaucratic apparatus, how his or her work integrates with that of others, with an ultimate impact on the taxpaying customer.

Finally, it would be hard to avoid the conclusion that unless IRS resources rise to a level comparable to that of counterpart agencies in other developed economies, American tax administration will not remain on par.[50] Some taxpayers will receive service while the IRS will collect from some transgressors. Other taxpayers, especially those in underserved sectors identified in the following MSPs, may face so many obstacles that they abandon voluntary compliance, especially if enforcement becomes so uneven as to create a perception that scofflaws go undetected. With ingenuity, social and technological innovations can address taxpayer needs and preferences while integrating employees into the mission of the IRS

47 *Office Organization*, Carbons to Computers, *op. cit.*

48 *See* John Tierney, *From Cubicles, Cry for Quiet Pierces Office Buzz*, NY Times (May 19, 2012) (discussing trade-off between communication and privacy).

49 This paragraph quotes from IRS Training Pub. 28667-002, *Front Line Manager Course: Participant Guide* (Aug. 2011) 6-3.

50 *See* National Taxpayer Advocate 2011 Annual Report to Congress 3 (Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*).

as a whole. This effort harks back to principles raised within the IRS when introducing sociotechnical design two decades ago:

> *In analyzing the **work system**, importance is attached to technological issues and organizational/employee/human issues according to the findings of an **equally rigorous** study of each issue. This is in contrast to the traditional design and development process for information systems, where the true costs of possible adverse organizational impacts tend not to be accounted for, nor is a methodology used that is designed to guard against these impacts.*[51]

51 IRS, *Draft Work System Design Handbook: A Guide to Integrating Technology with Human and Organizational Factors*, Doc. 7733, Cat. No. 13057F (Mar. 1991), Intro. at 3.

MSP #12 The IRS Telephone and Correspondence Services Have Deteriorated Over the Last Decade and Must Improve to Meet Taxpayer Needs

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Faris Fink, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The IRS mission statement — "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all" — reflects the obligation of the agency to provide the means for all taxpayers to meet their tax obligations.[1] When the IRS cannot adequately answer taxpayers' telephone calls or correspondence, and sets declining expectations for performance, it cannot execute its mission.[2]

As the IRS faces budget cuts and places an increased emphasis on enforcement, key performance measures of taxpayer service have declined, including:

- The IRS received over 100 million calls in fiscal year (FY) 2012 and more than 30 percent went unanswered.[3]
- The IRS received about 10.5 million pieces of correspondence, and at the end of the last week of FY 2012, nearly 48 percent was "overage."[4]
- In FY 2012, the IRS answered almost 68 percent of taxpayer calls and in FY 2013 set a goal of answering only 63 percent, a seven percent decrease.[5]
- Wait time to speak to an IRS representative was nearly 17 minutes in FY 2012, compared with under three minutes in FY 2004, an increase of over 500 percent.[6]
- In FY 2012, the IRS received calls to the CAS and AM lines from over 75,000,000 unique telephone numbers with an average of two calls per phone number.[7]

1 IRS, *The Agency, Its Mission and Statutory Authority, available at* http://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority (last visited Sept. 4, 2012).

2 IRS, Wage & Investment (W&I) Business Performance Review, 3rd Quarter, 20 (Aug. 15, 2012).

3 IRS, Joint Operations Center, Snapshot Report, September 30, 2012. Customer Account Services (CAS)/Accounts Management (AM) telephone lines included 29 toll-free lines in 2012). The IRS received 107,815,335 net call attempts to the CAS or AM lines in FY 2012, of which 30,788,921 were answered by a customer service representative (CSR). A total of 35,986,931 calls were answered by IRS automated call lines. The CSR level of service (LOS) is 67.6 percent.

4 Certain IRS inventories must be worked within a specific timeframe to be considered timely. If not closed in that timeframe, the inventory item will be classified as "overaged." IRS, *Accounts Management Inventory Report: National Inventory Age Report*, (Sept. 29, 2012). IRS, Joint Operations Center Reports, Accounts Management Inventory FY 2012. In FY 2012, 47.8 percent of the unresolved correspondence was considered overaged.

5 IRS, W&I Business Performance Review, 24 (Aug. 15, 2012).

6 IRS, Joint Operations Center, Snapshot Reports, September 30, 2005 and September 30, 2012. Figures for 29 CAS/AM lines.

7 IRS, Joint Operations Center, Executive Summary Report, Accounts Management Rollup FY 2012. Unique number information is based on all calls placed to IRS on CAS or AM lines. IRS Enterprise received 154,728,573 calls from 77,177,476 unique phone numbers in FY 2012. Unique phone numbers may be understated due to multiple callers from one private branch exchange or phone number.

Key measures of phone and correspondence services continue to decline as demand for service increases. From FY 2004 through FY 2012, the level of service on the CAS phone lines decreased nearly 23 percent.[8] During the same period, the length of time taxpayers must wait on the CAS line before reaching an assistor has increased by over 500 percent to almost 17 minutes.[9] Not only is the IRS answering a lower percentage of calls seeking live assistance, but those who do reach an assistor must wait increasingly longer to talk to one. At the same time, correspondence service is also decreasing, with a 315 percent increase in correspondence classified as overage in the final week of FY 2004 versus the final week of FY 2012.[10] In the 2012 filing season, the IRS had no special tax provisions to implement, such as the Make Work Pay or First-Time Homebuyer credits from previous filing seasons, that would lead to a decrease in service, suggesting that fundamental taxpayer service has simply deteriorated over the last decade.

Phones and correspondence represent taxpayers' main methods of communication with the IRS. As call volumes continue to rise, answering the phones to provide timely and comprehensive service to taxpayers must remain a priority. To serve taxpayers effectively, conducting rigorous research and analysis to understand what services are best provided through each channel, and using this information to guide the overall service strategy, is crucial. Applying the results of research and analysis to strategic service decisions will help the IRS allocate resources appropriately to meet taxpayer needs.

ANALYSIS OF PROBLEM

Background

Taxpayers call the customer service toll-free lines for many reasons. Prior to filing a tax return, a taxpayer may have an inquiry about the tax law or a question on how to prepare a form. After filing, taxpayers may want to check the status of a refund or respond to an IRS notice such as a math error notice.[11] Or a taxpayer might call because he or she has not received a timely reply to correspondence.

Taxpayers correspond with the IRS for the same reasons they call, or because they cannot reach a live assistor by phone, or may disconnect the call after being on hold for extended periods. Taxpayers may also write rather than call or visit a Taxpayer Assistance Center (TAC) or attempt to find an answer on the Internet when they cannot spend time away

8 IRS, Joint Operations Center, Snapshot Reports FY 2004-2012.

9 *Id.* The actual data was provided in seconds and converted to minutes. In FY 2004, average phone wait time was 158 seconds (2.6 minutes) and in FY 2012, it was 1001 seconds (16.7 minutes).

10 Certain IRS inventories must be worked within a specific time to be considered timely. If not closed in that period, the inventory item will be classified "overaged." IRS, Joint Operations Center, Accounts Management Inventory Reports FY 2004-2012. In FY 2004, 11.5 percent of correspondence was classified as overage compared to 47.8 percent in FY 2012.

11 A math error notice is a computer generated notice informing the taxpayer that the IRS changed the taxpayers return based on an error identified in the processing of the return.

from work or other obligations to wait on hold or wait in line at a TAC.[12] In a survey of TAC customers in April 2012, members of the Taxpayer Advocacy Panel (TAP) asked taxpayers if they had attempted to contact the IRS by another means before visiting the TAC. About two of every three of these taxpayers stated they had contacted or attempted to contact the IRS by some other method before coming into the office (approximately 34 percent said they visited the IRS website prior to visiting the TAC and 25 percent said they phoned first).[13]

In FY 2012, the IRS taxpayer service functions received almost 110 million incoming phone calls and over ten million pieces of correspondence.[14] While the IRS's workload has increased significantly, its budget has not grown to meet the demand despite repeated warnings from top IRS officials, including the National Taxpayer Advocate.[15] In FY 2012, taxpayers made almost 110 million attempts to call the CAS toll-free lines, up from nearly 100 million in FY 2011.[16] The IRS's budget was reduced slightly from FY 2010 to FY 2011,[17] and was lowered by an additional 2.5 percent for FY 2012.[18] These reductions affect the IRS's operations overall, and are particularly likely to impact taxpayer service. W&I Division Taxpayer Services began FY 2012 with almost 19,000 permanent employees, down nearly six percent from the FY 2011 level of just over 20,000.[19] With an unknown budget for the current (2013) fiscal year and the possibility of mandatory across-the-board cuts, the decline in IRS resources appears to be a continuing trend for the near future.[20]

12 *See* Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra*.

13 The TAP is a federal advisory committee comprised of a group of citizen volunteers who work to improve IRS services by providing the taxpayers' perspective to various IRS operations. The National Taxpayer Advocate and TAS's Research and Systemic Advocacy staffs supported the design, compilation, and analysis of the survey. TAP volunteers returned 664 completed surveys from 33 different TAC offices. While these results are not statistically representative of all TAC visitors, they represent the needs and activities of a sizable number of TAC customers during one week in the tax filing season. Percentages shown are out of all 664 respondents. Some respondents did not answer every question.

14 IRS, Joint Operations Center, Snapshot Report FY 2012; IRS, Joint Operations Center, Accounts Management Reports, FY 2008-2012 Inventories. In FY 2012, the CAS/AM toll free lines received 107,815,335 net call attempts, of which 30,788,921 were answered by a CSR. A total of 35,986,931 calls were answered by IRS automated call lines. The CSR LOS is 67.6 percent. The AM function received 10,471,205 pieces of correspondence.

15 For a full discussion of the National Taxpayer Advocate's concerns regarding the IRS' notice clarity, see National Taxpayer Advocate 2011 Annual Report to Congress 3-14 (Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*).

16 IRS, Joint Operations Center, Snapshot Reports FY 2011-2012. There were 107,815,396 attempts to reach a CSR assistor in FY 2012; in FY 2011, there were 98,438,779. In FY 2012, the CAS phone lines were renamed to AM. The AM summary includes calls from 29 toll-free lines including xxx-xxx-1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 1778, 9887, 9982, 2942, 4184, 7388, 0452, 0352, 7451, 9946, 5084, 5215, 3536, 4059, 4778, 4259, 8482, 1000, 1099, 5500, 4490.

17 Department of Defense and Full-Year Continuing Appropriations Act, 2011, Pub. L. No. 112-10, § 1119, 1125 Stat. 38, 107 (2011). These figures represent all personnel funded under the Taxpayer Service appropriation for PP 20B. Other possible budget categories include Enforcement, Operations Support, BSM, or HITCA.

18 H.R. 2055, Consolidated Appropriations Act, 2012, Division C, Title I (112th Cong.).

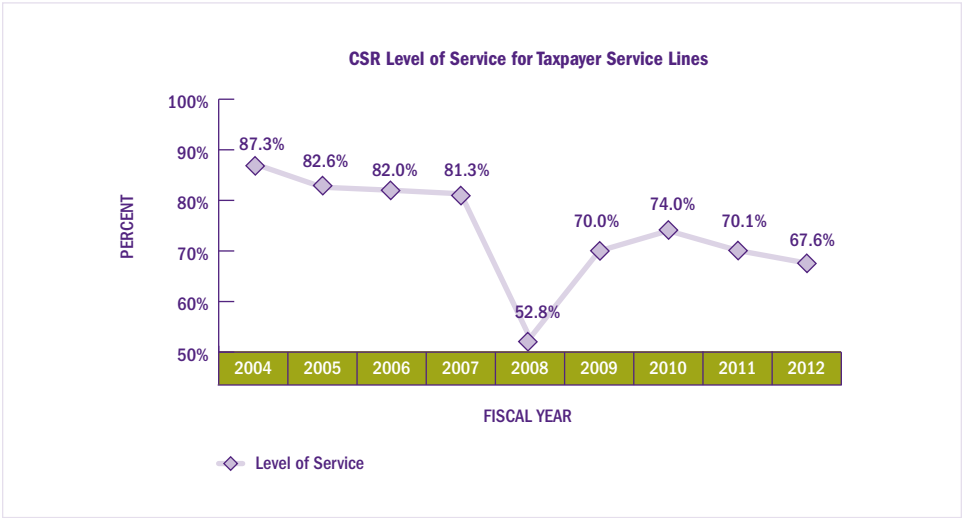
19 IRS, W&I Business Performance Review, (Aug. 15, 2012). In FY 2011, W&I Taxpayer Services had 20,042 permanent employees compared to 18,919 employees at the beginning of FY 2012. This represents a 5.6 percent decline in permanent employees. Taxpayer Services includes areas such as Submission Processing, AM, and TACs.

20 *See* Most Serious Problem: *The IRS is Significantly Underfunded to Serve Taxpayers and Collect Tax, supra*.

Service Levels in Customer Account Services Have Steadily Decreased.

The CAS toll-free lines serve as a primary channel for taxpayers with filing questions or account issues. In FY 2004, the IRS answered over 87 percent of these calls but in FY 2012 it answered only about 68 percent — a decline of nearly 23 percent.[21]

FIGURE 1.12.1, Level of Service for CAS/AM Toll-Free, FY 2004–FY 2012[22]



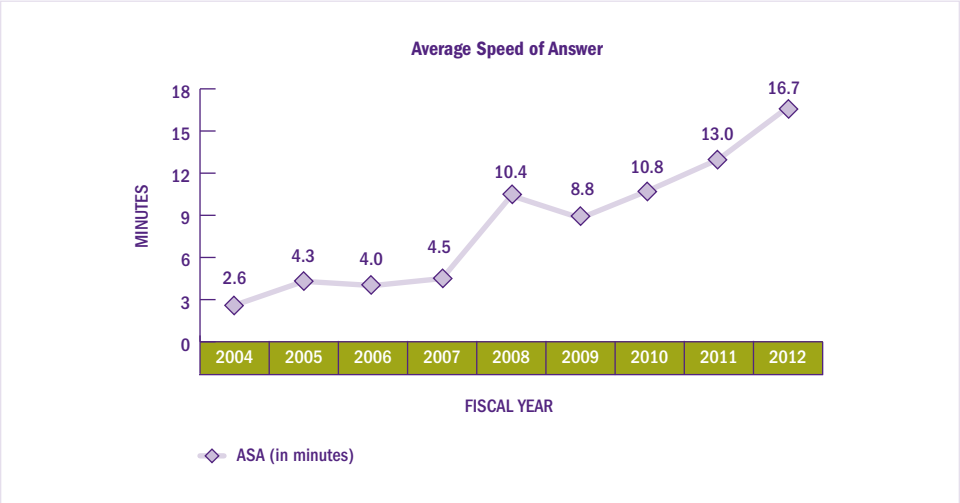
In the same period, the time it takes to reach a phone assistor in the CAS functions has risen over 500 percent — from just below three minutes to almost 17 minutes, as illustrated below.[23]

21 IRS, Joint Operations Center, Snapshot Reports FY 2004-2012.

22 *Id.* CSR LOS is the percentage of callers seeking live assistance who reach a live assistor.

23 IRS, Joint Operations Center, Snapshot Reports FY 2004-2012. The actual data was provided in seconds and converted to minutes. In FY 2004, average phone wait time was 158 seconds (2.6 minutes) and in FY 2012, it was 1001 seconds (16.7 minutes).

FIGURE 1.12.2, CAS/AM Toll-Free Average Speed of Answer, FY 2004–2012[24]



The continuing decrease in the IRS's ability to answer calls, coupled with the increasing time it takes to reach an assistor, impedes certain groups of taxpayers from communicating with the IRS by phone, and limits the usefulness of the toll-free lines for all. Taxpayers with limited time to wait on hold or with restricted access to phone service must either attempt to visit a TAC, write the IRS, or simply choose to drop their inquiry and not resolve their issues. While the decline in LOS and increase in waiting time in certain years may have been caused by temporary tax provisions, such as the Make Work Pay Credit or the First-Time Homebuyer Credit, in 2012 there were no such provisions to drive a lower LOS or ASA on the main toll-free line.

Phone Service Issues Are Not Limited to the IRS Main Toll-Free Lines.

Customer service across IRS phone lines has generally declined since FY 2004.[25] LOS has decreased and ASA is longer across the Practitioner Priority Service (PPS), National Taxpayer Advocate, and Tax Exempt and Government Entities (TE/GE) organizations lines.[26] The PPS line is a professional support line staffed by IRS employees specifically trained to address practitioner questions.[27] From FY 2004 through FY 2012, ASA on the PPS line has increased by almost 1,100 percent, with practitioners having to wait an average of over 22 minutes to speak to a customer service representative.[28] Such delays frustrate practitioners

24 IRS, Joint Operations Center, Snapshot Reports FY 2004-2012. The actual data was provided in seconds and converted to minutes. In FY 2004, average phone wait time was 158 seconds (2.6 minutes) and in FY 2012, it was 1001 seconds (16.7 minutes).

25 SB/SE and W&I Automated Collection System phone lines have maintained fairly consistent LOS and ASA since FY 2004. IRS, Joint Operations Center, Snapshot and Product Line Detail Reports FYs 2004-2012.

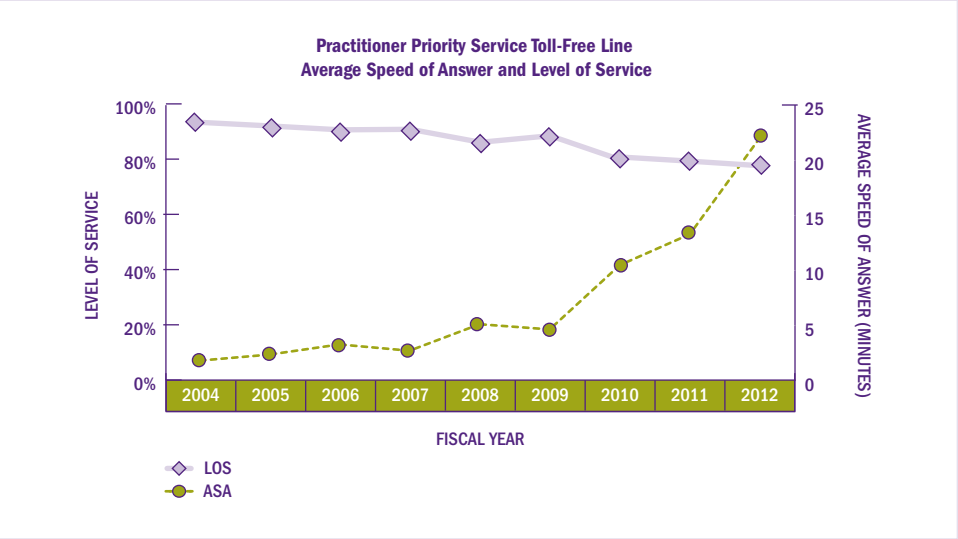
26 The National Taxpayer Advocate Hotline is staffed by W&I CSRs. The TE/GE LOS has increased since FY 2004, but declined since FY 2010. IRS, Joint Operations Center, Product Line Detail Reports FY 2004-2012,

27 IRS, Practitioner Priority Service, *available at* http://www.irs.gov/Tax-Professionals/Practitioner-Priority-Service-%C2%AE (last visited Nov. 1, 2012).

28 IRS, Joint Operations Center, Product Line Detail Reports FY 2004-2012. ASA in FY 2004 was 1.85 minutes, compared to 22.05 minutes in FY 2012.

and cost taxpayers money, as their representatives spend time waiting for the IRS to answer the phone. During the same period on the PPS line, LOS has decreased by more than 20 percent.[29]

FIGURE 1.12.3, PPS Line LOS and ASA FY 2004–2012[30]



The decline in phone services also extends to the IRS's TE/GE line. The LOS on the TE/GE line has dropped 15 percent in only two years, from 81 percent in FY 2010 to 68.5 percent in FY 2012.[31] ASA on the TE/GE line has increased by more than 200 percent since FY 2009 to over 16 minutes in FY 2012.[32]

At the Same Time Telephone Service Is Declining, the Volume of Aged, Unprocessed Correspondence Is Growing.

Even as it becomes more challenging to communicate with the IRS by phone, it has also become more difficult for taxpayers to obtain a response to their correspondence. Comparing the final weeks of fiscal years 2004 and 2012, the backlog of correspondence in the tax

29 IRS, Joint Operations Center, Product Line Detail Reports FY 2004-2012. In FY 2004, LOS was 93.3 percent and in FY 2012, it was 73.4 percent. For a full discussion of the National Taxpayer Advocate's concerns about service to practitioners, see Most Serious Problem: *IRS Processing Flaws and Service Delays Continue to Undermine Fundamental Taxpayer Rights to Representation, infra*.

30 *Id.*

31 *Id.*

32 *Id.* In FY 2009 ASA on the TE/GE line was 5.23 minutes compared to 16.35 minutes in FY 2012. For further discussion of the National Taxpayer Advocate's concerns regarding TE/GE customer service, see Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations, supra*.

adjustments inventory has jumped by nearly 190 percent.[33] During the same period, the percentage of correspondence classified as "overage" has increased by over 315 percent.[34]

FIGURE 1.12.4, Adjustments Ending Correspondence Inventory Volumes, FY 2004–FY 2012[35]

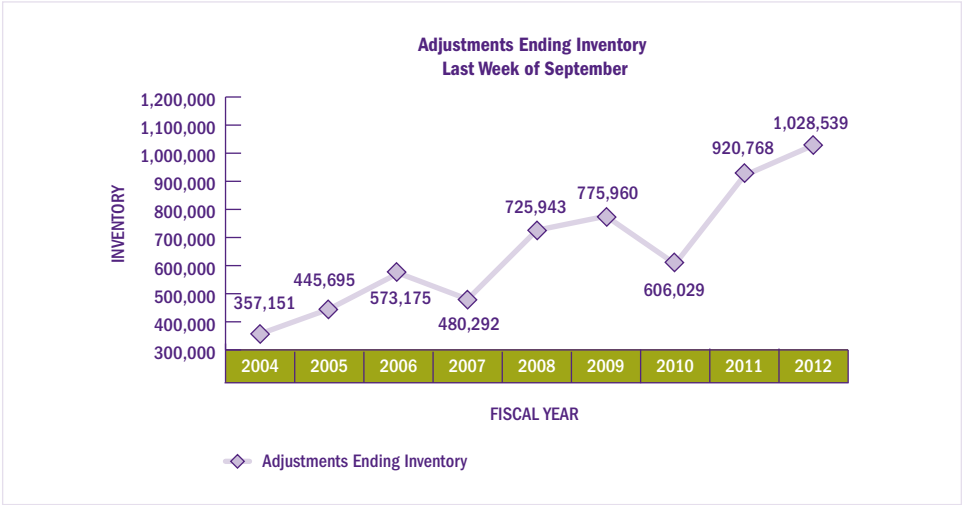
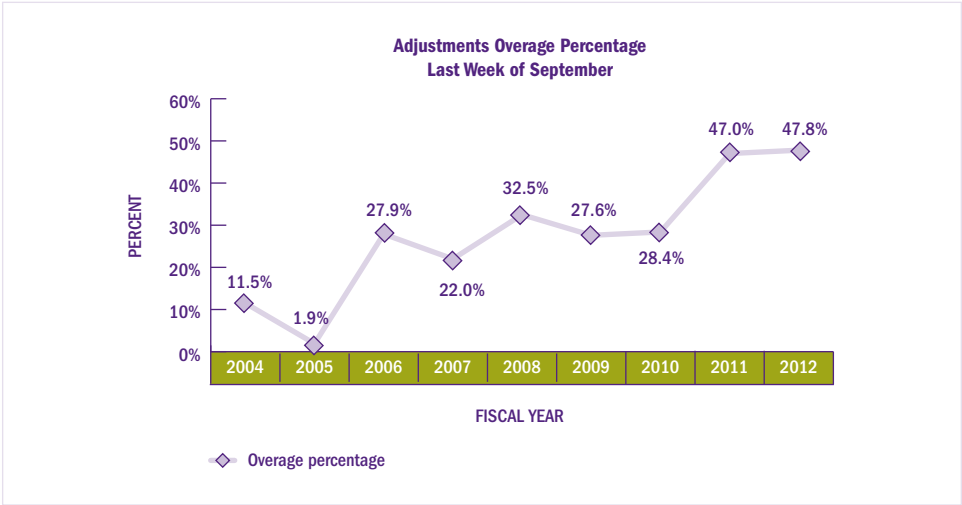


FIGURE 1.12.5, Adjustments Ending Correspondence Overage Percentage FY 2004–FY 2012[36]



33 IRS, Joint Operations Center Reports, Accounts Management Inventory Report FY 2004-2012.

34 Certain IRS inventories must be worked within a specific time to be considered timely. If not closed in that period, the inventory item will be classified "overaged." *Id.* In FY 2004 11.5 percent of correspondence was classified as overage, compared to 47.8 percent in FY 2012.

35 *Id.*

36 IRS, Joint Operations Center, Accounts Management Inventory Report FY 2004-2012.

Allocating Resources to the Appropriate Service Channels Is Crucial.

The National Taxpayer Advocate understands that the IRS must allocate a finite amount of resources among increasing work demands. For this reason, TAS invited W&I to join in developing a methodology that will help the IRS decide how to allocate taxpayer service resources by taking into account both government and taxpayer needs and expectations. Using Government Value and Taxpayer Value as its ranking criteria, the Service Priority Project team is developing a measured set of taxpayer services that can be used to identify priorities when budget or staffing issues dictate a change in services.[37] TAS has proposed three additional taxpayer value measures for the tool; however, W&I has not accepted those measures at this time. Research conducted to populate the values in the ranking tool will assist the IRS in understanding the best channel for each taxpayer service and optimizing its overall taxpayer service strategy.

The IRS Unnecessarily Increases Demand for Services Through Its Own Work Processes.

Notwithstanding recent IRS efforts to improve the clarity of its correspondence, IRS notices often confuse taxpayers and lead them to contact the IRS for an explanation or to find out the next steps. On the other hand, the IRS increases its own workload and creates taxpayer burden by sending notices that require responses even when the IRS already has the information it needs to correct an error.[38] For example, Taxpayer A has been claiming Dependent B on his tax return for the last ten years. This filing season, Taxpayer A inadvertently transposes two digits of Dependent B's Social Security number (SSN) on the return. Although the IRS could easily correct this error, as the correct SSN is shown on the taxpayer's previous filings, the IRS instead issues a math error notice that requires the taxpayer to contact the IRS to correct the return and takes on average about 12 weeks to resolve[39].

The IRS allows taxpayers to conduct simple actions through IRS.gov, but taxpayers cannot use the site for routine tasks such as:

- Correcting computational errors;
- Checking account status;
- Obtaining prior year return information immediately; or
- Making an individual tax payment.

By requiring a taxpayer to write, call, or visit a Taxpayer Assistance Center to complete these tasks, the IRS creates a higher volume of calls, correspondence, and TAC visits.

37 IRS, W&I Business Performance Review, (Aug.15, 2012).

38 For a full discussion of the National Taxpayer Advocate's concerns regarding the IRS' notice clarity, see National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*). *See also* National Taxpayer Advocate 2011 Annual Report to Congress Volume II 113-144 (Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued on Claimed Dependents*).

39 2011 National Taxpayer Advocate Annual Report to Congress, (Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*, Table 9, 138). The median time to resolve this math error notice is four weeks.

Moving tasks to the Internet would permit willing taxpayers to use this channel for routine actions and could reduce stress on IRS telephone and correspondence resources, allowing IRS assistors to focus on taxpayers who need and prefer the phone or correspondence. The IRS has made progress improving taxpayer services provided via the Internet, including the release of the "Where's My Refund" web tool and smartphone application. However, this in itself has created additional demand on the toll-free lines at times when systems were unavailable or provided an unclear response.[40]

CONCLUSION

Failing to provide service to taxpayers who require IRS assistance creates a burden for taxpayers who cannot resolve their tax issues timely. Downstream consequences of being unable to reach the IRS may include not filing a return, filing inaccurate returns, spending money on paid practitioners, or accumulating greater penalties or interest. By understanding through rigorous research and analysis what tasks taxpayers need to accomplish over the phones and correspondence, the IRS can appropriately allocate all taxpayer service resources to meet demand. With declining LOS and increasing ASA across many IRS phone lines, combined with increasing levels of overage correspondence, taxpayers are not receiving top quality service and may not be able to meet their tax obligations.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Collect data related to telephone and correspondence service levels, satisfaction levels, receipts, etc., in a global manner to understand the scope of taxpayer needs and assess overall telephone and correspondence service metrics.
2. Conduct studies such as the TAS Dependent Taxpayer Identification Number Math Error Study to identify unnecessary correspondence and take action to minimize taxpayer burden and delays caused by unnecessary correspondence.
3. Use data the IRS has collected and analyzed to make taxpayer service decisions and resource allocations through an overall service strategy. Commit to using the jointly developed ranking tool in all taxpayer service policy decisions, including the taxpayer value measures proposed by TAS, to completing the research necessary to fully populate the tool's data fields, and to extending the methodology to enable scoring of changes to the way covered services are delivered (e.g., increases or decreases in the level of service or available service hours for a service activity).[41]

40 A complete list of tools for individual taxpayers can be found *at* http://www.irs.gov/uac/Tools (last visited December 31, 2012). *See* Treasury Inspector General for Tax Administration, Ref. No. 2012-40-036, *Interim Results of the 2012 Filing Season* (Mar. 30, 2012). For further discussion of the National Taxpayer Advocate's concerns about Internet services and the progress the IRS has made, see Most Serious Problem: *The IRS is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to Be Done, infra*.

41 We have also made this recommendation in the Most Serious Problem: *The IRS Lacks a Servicewide Strategy the Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra.*

IRS COMMENTS

The IRS places high importance on customer service, and we constantly strive to improve the customer experience. The IRS monitors telephone service in real time and constantly takes steps to move staff from programs that are less busy to telephone services with longer wait times. We routinely look at ways to decrease customer wait times and improve efficiency. We are exploring new technology such as virtual queuing, which provides customers the ability to request a call back during especially busy times in lieu of waiting on line, and electronic fax, which enables our assistors the ability to send and receive documents directly from employee workstations. These efforts are aimed at reducing telephone handle times and improving the customer experience. In addition, we are continually studying the reasons taxpayers need to contact us, which enables us to better serve them.

Each year millions of taxpayers call the IRS for assistance with account-related issues or to obtain tax law related information needed to file tax returns. There were approximately 46 million customers seeking live assistance during FY 2012.

We have increased the total number of IRS toll-free customers served each year from 69.3 million in 2004 to over 90 million in 2012, a 29.9 percent increase. This is due, in large part, to a significant increase in the number of customers served through automation, which increased from 33.8 million in 2007 to over 59 million in 2012. While we recognize that personal service is highly valued by many of our customers, automated service is more efficient and provides services that are consistent, reliable, and available at all hours. And because of changing customer demographics, automation is becoming the preferred contact channel for many of our customers seeking answers to tax law questions and those with less complicated account issues. By providing automated options for these customers, our assistors are available to concentrate on more complex inquiries, and we are able to serve a larger number of customers overall.

Overall demand has increased in recent years. In FY 2008, economic stimulus legislation prompted an unprecedented number of taxpayers to call the IRS, which had a significant negative impact on CSR LOS. After FY 2009, demand for toll-free service subsided but did not return to pre-stimulus levels. In FY 2012, demand was 50 million, about five million higher than the levels experienced between FY 2004 and FY 2007. This level of demand appears to be the "new normal."

Just as we explore ways to improve telephone service, we also continually look at ways to improve service to our customers who contact us via correspondence. Accounts Management currently utilizes an extensive suite of correspondence metrics to effectively track volume, timeliness, and case priority.

- The IRS uses the Correspondence Imaging System inventory report to monitor weekly overage work and priority inventory, and track closed cases compared to the overall inventory.

- In FY 2011, Accounts Management implemented a new Site Level Indicators and Measures Report, which includes the tracking of cycle time and average days to close correspondence at the site as well as the aggregate levels, enabling the IRS to monitor timely service to the taxpayer.
- We utilize the Embedded Quality Timeliness measure to determine the timeliness and accuracy of responses to taxpayer correspondence and whether employees follow established timeframes and proper workload management guidelines.

As an organization, over the past two decades, we have annually asked our customers how we can improve our service. These surveys have two primary goals:

1. To measure customer satisfaction to meet a balanced measure requirement; and
2. To identify improvement opportunities as the basis for enacting improvements.

The IRS measures correspondence customer satisfaction as part of the "Adjustments Customer Satisfaction Survey." This survey includes responses to notices, letters, unsolicited correspondence, amended returns, and claims.

Our Field Collection Areas have led the way in reaching out to our customers to improve case quality. For example, Field Collection recently took steps to keep their customers apprised as to the status of their case by developing and implementing case closing letters. These letters let many of our customers know when their case has been closed or resolved. They also continually strive to reduce time spent on a case by improving the quality of our initial contacts and educating taxpayers on their important role in case resolution.

In addition, many Collection Areas hold quarterly Collection Liaison meetings with local practitioners. At these meetings, local practitioners meet with Territory Managers, Group Managers, and Revenue Officers. During these meetings, presentations are given on various topics relating to the collection process and practitioners are always given the opportunity to discuss their concerns in a non-confrontational atmosphere. This outreach has received much praise from the practitioner community and is expected to grow.

The IRS is pleased to partner with TAS on the Service Priority Project, which will quantify the value of service tasks by service channel (*i.e.,* face-to-face, assisted and automated telephone, and online), based on government and taxpayer value criteria. The service tasks are defined at a broad level, *e.g.*, providing general tax law assistance and information and providing tax account assistance.

The ranking tool is still under development. The IRS will use the ranking tool as guidance along with other relevant information when making decisions about changes to taxpayer services. Additionally, the IRS will incorporate the three criteria proposed by TAS into the ranking tool as data become available. In the meantime, information available about these criteria will be included as addenda to the services' score sheets. This ranking tool is a tool

in the decision-making process; therefore, the information in the addenda will inform the decisions.

The IRS will modify existing surveys in order to collect data that will populate the data gaps in the current model. These modifications will be constrained by budget considerations. For example, an increased sample size necessary to collect the detailed data for the model will increase the survey cost.

The ranking tool is not designed to provide information about the impact of specific changes in service attributes (*e.g.*, hours of operation, wait time, etc.). The IRS will evaluate the cost-effectiveness of conducting research that will provide the detailed data that would be needed to quantify the changes in service attributes (*e.g.*, level of service, hours of operation).

The National Taxpayer Advocate has recommended that the IRS collect data related to service and satisfaction levels in a global manner to understand needs and assess metrics. The IRS currently collects an extensive suite of telephone and correspondence performance metrics. The data collected is used to assess taxpayer needs and identify improvement actions. Although there is currently an extensive suite of correspondence metrics in place which effectively track volume, timeliness, and case priority, the IRS is constantly striving to improve the customer experience. The IRS has tools in place to monitor cycle time, average days to close correspondence, weekly overage work and priority inventory, and track closed cases compared to the overall inventory. We also utilize the Embedded Quality Review System timeliness measure to evaluate whether caseworkers took timely case action. The IRS places high importance on customer service and will continue to review, update, and augment the current suite of metrics for the correspondence program, as needed.

Finally, the National Taxpayer Advocate has recommended that the IRS conduct studies to identify unnecessary correspondence and take action to minimize taxpayer burden caused by unnecessary correspondence. In an effort to reduce taxpayer burden and better understand the taxpayer decision-making process of contacting the IRS in response to Information Only (IO) notices, W&I Research and Analysis (WIRA) identified eight high-impact, high-volume notices that do not require a response from the taxpayer. WIRA conducted twelve focus groups with taxpayers and IRS Customer Service Representatives (CSRs) in May and June 2012. WIRA found that a taxpayer's main motivation for calling the IRS in response to IO notices is to obtain information. WIRA obtained a number of suggestions for improving the notices.

Taxpayer Advocate Service Comments

Providing quality service to a large and varied taxpayer population is crucial to the IRS mission. The National Taxpayer Advocate is pleased that the IRS recognizes the value of improving the customer experience. TAS fully supports the expansion of electronic tools for IRS telephone assistors and taxpayers to decrease burden and shorten the time needed to resolve problems.[42]

While automated options are an important component of a comprehensive taxpayer service strategy, the IRS cannot rely solely on these options to close gaps. As the tax code grows more complex, taxpayer issues become increasingly difficult and less suitable for automation. Additionally, the IRS knows that certain segments of the taxpaying public are unable or unwilling to use automation, and that it must provide them with quick, efficient phone service.

The National Taxpayer Advocate is pleased that the IRS is looking at a set of Information Only notices to improve the quality of existing notices and decrease the need for taxpayers to call the IRS in response. This is a first step, but the IRS not addressing the other underlying issues that drive unnecessary taxpayer contacts. For instance, the IRS declined to comment on the possibility of using its own records to correct simple math errors, such as a transposed Social Security number for a dependent, which would remove the need to even correspond with the taxpayer. Elimination of unnecessary "action required" notices will reduce phone calls and correspondence as well as taxpayer burden.

Finally, the National Taxpayer Advocate also is pleased that the IRS has agreed to incorporate TAS criteria in its jointly-developed service ranking tool and will use this tool to make future taxpayer service decisions. However, the IRS must remain aware of the taxpayer perspective as it decides how to deliver services. Failing to fully populate the ranking tool data before changing its taxpayer service strategy will cause the IRS to continue making decisions in a vacuum. The IRS must commit to recognizing the importance of the taxpayer experience with IRS services, and use internal and external research to fully understand the impact and consequences of service changes. It should be a budget priority to complete the research and data collection necessary to make the ranking tool effective. While populating the tool will require an investment upfront, it will enable the IRS to make better decisions and target resources more appropriately in the long run.

42 In the most recent IRS, W&I Business Performance Review, 26 (Nov. 14, 2012), the IRS has revised its goal for Level of Service to 70 percent from 63 percent,

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Conduct studies (such as the TAS Dependent Taxpayer Identification Number Math Error study) to identify unnecessary "action required" correspondence and act to minimize taxpayer burden and delays caused by this correspondence.
2. Use data the IRS has collected and analyzed to make taxpayer service decisions and resource allocations through an overall service strategy.
3. Commit to using the jointly-developed ranking tool in all decisions about taxpayer service policy, including the taxpayer value measures proposed by TAS; to completing the research necessary to fully populate the tool's data fields, and to extending the methodology to enable scoring of changes to the way covered services are delivered including increases or decreases in the level of service or available service hours for a service activity.[43]

[43] We have also made this recommendation in the Most Serious Problem: *The IRS Lacks a Servicewide Strategy the Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra.*

MSP #13 The IRS Has Failed to Make Free Return Preparation and Free Electronic Filing Available to All Individual Taxpayers

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Carol Campbell, Director, Return Preparer Office

DEFINITION OF PROBLEM

Taxpayers today have an array of options for filing their returns, but not all taxpayers have the ability to prepare and e-file their returns for free. Low and middle-income taxpayers typically lack the knowledge and skills needed to prepare their own returns. Many cannot afford to pay for return preparation, and depend upon the free services of IRS employees at Taxpayer Assistance Centers (TACs), volunteers at Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites, and online products and services offered by the Free File Alliance (FFA).[1] In addition, many taxpayers who do have the skills to prepare their own returns do not qualify for or know about Free File, leaving them to pay for private-sector software products. Reliance on the private sector for return preparation creates vulnerabilities, including a lack of consistency among commercial products in incorporating recently enacted or infrequently applied tax provisions. Moreover, a recent TAS evaluation of the information provided by IRS telephone assistors revealed the IRS failed to provide VITA site accessibility information in 90 percent of the calls, and failed to provide language availability at VITA sites nearly 60 percent of the time.[2]

In 1998, Congress directed the IRS to develop a return-free tax filing alternative.[3] Many other countries now use alternative tax systems (*e.g.*, "return free" and "pre-populated" return systems) to simplify tax administration.[4] The rationale for doing so is compelling. These systems often require real-time information reporting, which provide greater accuracy, improved compliance, and reduced taxpayer burden.[5] The Government Accountability Office (GAO) has estimated that by adopting a similar system, the IRS could free tens of millions of taxpayers from the requirement to prepare returns, saving taxpayers over 155 million hours of tax preparation time and hundreds of millions of dollars in

1 The FFA is a group of private sector tax software companies that provide free tax software and e-filing under an agreement with the IRS.

2 TAS, VITA Site Survey (April 2012).

3 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 title II, § 2004, Pub. L. No. 105-206 title II, 112 Stat. 726 (Jul. 22, 1998).

4 In 2006, the Organization for Economic Cooperation and Development (OECD) studied the following countries that use prepopulated returns: Denmark, Estonia, Finland, Iceland, Norway, Sweden, Chile, and Spain. *See* OECD, Forum on Tax Administration: Using Third Party Information Reports to Assist Taxpayers Meet their Return Filing Obligations—Country Experiences With the Use of Pre-Populated Returns 4-5, 13 (Mar. 2006).

5 *See id; see also* General Accounting Office (GAO, now the Government Accountability Office), GAO/GGD-97-6, *Tax Administration: Alternative Filing System* 1, 4 (Oct. 1996).

return preparation fees.[6] The IRS could use the tens of millions of dollars it now spends resolving problems on incorrectly prepared returns to increase return preparation assistance for underserved taxpayers.[7] In 2010, TAC sites prepared electronic returns for only slightly more than one tenth of one percent of the eligible taxpayers, and less than half that number in 2012.[8]

The National Taxpayer Advocate is concerned about the way the IRS administers its return filing operations, specifically:

- The IRS has not developed a comprehensive plan that will give all taxpayers the option to prepare and e-file their returns for free;
- The IRS has not implemented the "Return-Free" tax system Congress directed it to develop in 1998.
- TACs increasingly turn away taxpayers seeking return preparation assistance, directing them to volunteers, commercial software, and paid preparers; and,
- The IRS relies on VITA for return preparation, but continues to give taxpayers inaccurate or incomplete information about site locations and provides the volunteer programs with tax software embedded with a costly commercial product.

ANALYSIS OF PROBLEM

Background

Basic principles of sound tax administration focus on improving taxpayer services and compliance.[9] It is widely recognized that, in furtherance of these principles, the tax administrator bears the ultimate responsibility for providing free return preparation and electronic filing.[10] However, as shown in Figure 1.13.1 below, U.S. taxpayers filed more than 136 million individual income tax returns during the 2012 filing season, through September 2012 (tax year 2011 returns), and over 75 million taxpayers (roughly 55 percent) used paid preparers.[11] If the IRS provided an electronic version of the paper Form 1040 on its website, and equipped it with computational capability, links to IRS publications, forms,

6 These figures are based on tax year 1992 data. Since then, millions more taxpayers have become eligible for certain refundable credits (*e.g.*, Earned Income Tax Credit, Additional Child Tax Credit) and must file returns. *See* GAO, GAO/GGD-97-6, Tax Administration: *Alternative Filing System* 2, 4, 8, 11, 20 (Oct 1996).

7 *Id.* at 41-42 (Oct 1996).

8 TAS Research, Compliance Data Warehouse, IRTF_F1040 table, data (Drawn Oct. 17, 2012). *See also*, IRS, Field Assistance E-File Report (April 2012); National Taxpayer Advocate FY 2012 Objectives Report to Congress 44. For an in-depth discussion of TAC Operations, see Most Serious Problem: *The IRS Lacks a Servicewide Strategy That Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra/supra*.

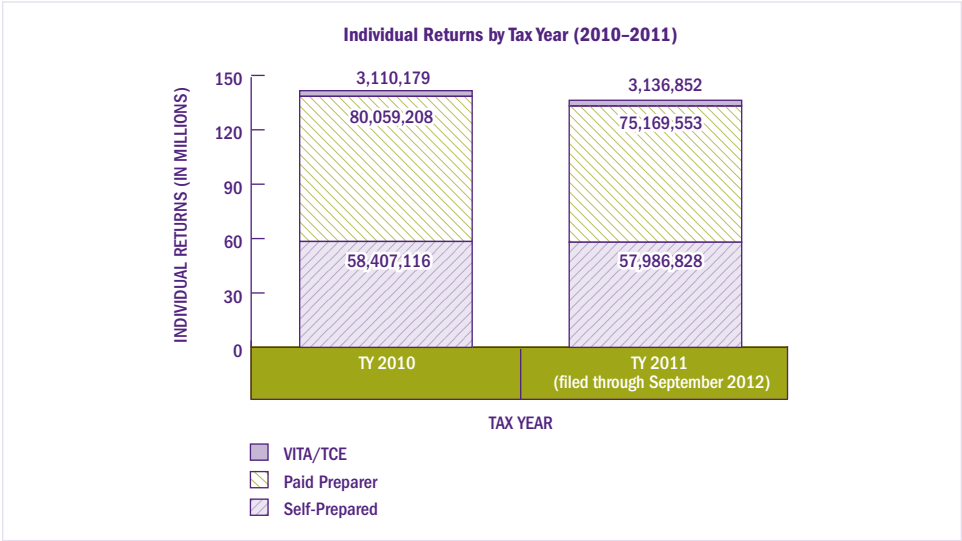
9 "A full-fledged and vastly expanded program of taxpayer assistance in the preparation of returns would drastically reduce audit requirements and in the long run be projective of substantially increased revenue." See Jt. Comm. on Int. Rev. Tax'n, Investigation of the Bureau of Int. Rev. 37 (Washington, DC: Gov't Printing Office, 1948).

10 OECD, Forum on Tax Administration: Taxpayer Service Sub-group, *Survey of Trends and Development in the Use of Electronic Services for Taxpayer Service Delivery* 12 (Mar. 2010).

11 TAS Research, Compliance Data Warehouse, ITRF_F1040 Table, data includes returns filed through September 2012, data drawn (Nov. 6, 2012). For tax year 2010, there were 80.1 million preparer-prepared returns, 58.4 self-prepared returns, and 3.1 million VITA/TCE-prepared returns, totaling 141.6 million returns.

instructions, and worksheets, all individual taxpayers could prepare and e-file their returns for free if they chose.

FIGURE 1.13.1, Breakdown of Individual Returns for Tax Years 2010 and 2011[12]



The IRS Has Not Developed a Comprehensive Plan to Enable All Taxpayers to Prepare and E-file their Returns for Free.

The IRS attempts to fulfill its responsibility with respect to tax preparation through a disjointed array of services and providers that has evolved over many years:

- IRS employees prepare returns for eligible taxpayers at TAC sites;[13]
- National and local partner organizations coordinate the annual training and IRS certification of thousands of dedicated VITA and TCE volunteers who prepare and e-file returns for eligible taxpayers throughout the United States;[14] and
- IRS Free File provides a host of free tax products and services to eligible taxpayers under an agreement with the Free File Alliance.[15]

12 TAS Research, Compliance Data Warehouse, ITRF_F1040 Table, data drawn (Nov. 6, 2012). During the 2012 filing season (tax year 2011), approximately 84 percent of individuals e-filed their returns and 16 percent filed paper returns. TAS Research, Compliance Data Warehouse, ITRF_Entity Table, data drawn (Nov. 6, 2012). Of the more than 3.5 million individuals who used the IRS's E-file with Free File Programs in 2012, 3.1 million taxpayers used IRS Free File, and 475,000 taxpayers used IRS Free Fillable Forms. IRS TAC sites transmitted slightly more than 100,000 returns. IRS, Field Assistance E-File Report (Nov. 2012). More than 21 million taxpayers filed paper returns, and roughly 62 percent of those taxpayers used tax preparation software but then mailed their returns instead of filing electronically (the IRS refers to these as V-Coded returns). TAS Research, Compliance Data Warehouse, IRTF_Entity Table, data drawn (Nov. 7, 2012).

13 IRM 21.3.4.10.2 (Apr. 18, 2012). GAO, GAO-08-38, Tax Administration, *2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated Highlights* (Nov. 2007).

14 IRS response to TAS information request, item 5 (Jul. 19, 2012). In 2012, the IRS reported it had 63,222 VITA volunteers and 35,662 TCE volunteers.

15 IRS Free File, *available at* http://www.irs.gov/uac/Free-File:-Do-Your-Federal-Taxes-for-Free (last visited Nov. 8, 2012); IRS, Advancing E-File Study Phase 2 Report Executive Summary: *An Examination of Options to Increase Electronic Filing of Individual Returns* 14 (Dec. 15, 2010).

The Free File Program has two components: Free File and Free Fillable Forms. Free File provides free software and e-filing to eligible taxpayers with adjusted gross income (AGI) of up to $57,000.[16] While all taxpayers, including those with higher incomes, may use Free Fillable Forms to prepare and e-file their returns, gaps in the current e-file systems do not allow all individuals to e-file their returns for free. For example, neither Free File, Free Fillable Forms, nor IRS e-file now supports all forms and schedules in the Form 1040 series (1040, 1040-A, and 1040-EZ). Consequently, some taxpayers must print and mail their returns to the IRS.

While e-file now supports the most common federal forms, Free File companies are not required to and do not offer all IRS forms and schedules.[17] To find forms and schedules not listed on the Free File website, the IRS directs taxpayers to the vendors' websites to find out if the forms are available. Free Fillable Forms now supports over 140 forms,[18] but does not support prior year returns and is not available for e-filing year-round. For example, in 2012, taxpayers could e-file via Free Fillable Forms from January 17 through October 15. Those who e-filed on or before October 15 were allowed until October 19 to correct and resubmit a rejected return. Taxpayers filing after that date had to file paper returns.[19] The IRS could bridge these gaps in services with a government-provided, electronic version of its Form 1040 with computational capability that supports e-filing for all 1040 series forms and schedules.

The National Taxpayer Advocate has previously addressed the significant limitations of IRS Free File. While Free File purports to offer free filing for up to 70 percent of individuals, vendors can and do impose additional eligibility criteria that vary from one vendor to another. This can make choosing a vendor confusing for taxpayers. Moreover, some products do not inform taxpayers that they are ineligible for free e-filing until after they

16 *See* http://www.irs.gov/uac/Free-File%3A-Do-Your-Federal-Taxes-for-Free (last visited Oct. 17, 2012).

17 For a list of forms supported by all Free File companies *see*, http://www.irs.gov/uac/Free-File---Most-Commonly-Filed-Federal-Forms-are-Available (last visited Oct. 16, 2012).

18 *See* http://www.irs.gov/uac/List-of-Available-Free-File-Fillable-Forms (last Visited October 16, 2012).

19 In 2012, taxpayers could not e-file returns using Free Fillable Forms if they were required to file any unsupported forms and schedules (*e.g.*, Form 8283, Noncash Charitable Contributions, when taxpayers must file Form 8283 with Form 1098C, *Contributions of Motor Vehicles, Boats, and Airplanes*; Forms W-2 or 1099 with a foreign address; and Schedule D, *Capital Gains and Losses with Expired or Worthless Securities*). Form 8839, *Qualified Adoption Expenses*, currently is not supported by Modernized e-File (MeF); Form 8453, *U.S. Individual Income Tax Transmittal for and IRS e-file Return* is a Legacy e-file system (ELF) form, which is not supported by MeF. Beginning with TY 2012 (filing season 2013), Free File Fillable Forms is expected to support Forms 1040 with a foreign address. *See* IRS response to TAS 7-day check for factual inaccuracies, Item 10 (Nov. 21 2012); Free File Fillable Forms FAQs & Limitations 1-2, 4 (April 6, 2012). *See also* IRS Free Fillable Forms and Limitations *available at* http://www.irs.gov/pub/irs-utl/2012_4f_faqs.pdf (last visited Oct. 16, 2012). *See also* IRS Report to Congress, *Progress on the Implementation of the Taxpayer Assistance Blueprint 39* (Oct. 2009). The IRS plans to update its FAQs to reflect the most recent changes.

have completed the bulk of the return.[20] Finally, some private vendors have been unwilling to incorporate late-enacted tax provisions into their Free File product.[21]

A government-provided electronic Form 1040 could also be designed to make returns easier to prepare by allowing taxpayers to directly import third-party data.[22] Taxpayers who feel they need professional help to prepare their returns could obtain it in much the same way taxpayers have done for years. Those who prefer to use the more sophisticated commercial software products, including those that link to bookkeeping, payroll, and accounting software, could continue to do so. The private sector could continue to receive fees for services and products such as consultation, training, sophisticated off-the-shelf commercial software, design of government-provided forms and services, and individualized advice on more complex returns.[23]

In developing an electronic Form 1040, the IRS could collaborate with the private sector by soliciting bids or renegotiating its existing agreement with the Free File Alliance for a comprehensive Fillable Forms Utility. However, the IRS would need to set the terms of any agreement and control the content and detailed specifications of what an electronic 1040 must contain. The IRS also would need to ensure the specifications meet the needs of taxpayers, and should not be constrained by the existing Free File limitations. Contracting with an outside vendor would allow the IRS to benefit from the expertise of the private sector yet retain control over the products for future changes.

The IRS has Not Implemented the "Return-Free" Tax System Congress Directed it to Develop in 1998.

In a 1987 study, the IRS reported that a "tax agency reconciliation system" was not feasible because of the time it took to process and correct third-party data, but could become viable in the future once more payers filed their information returns electronically.[24] By 1996, the

20 Some FFA companies do not offer free service to mature taxpayers (*e.g.*, age 50+) or those under 19. Some impose a maximum AGI threshold of less than $57,000 (the FFA limit for tax year 2012), and some have a minimum AGI threshold, as well. Others use military service as an eligibility criterion, and some products do not support state returns, while vendors whose products do support state returns often charge extra. *See* Advancing E-File Study Phase 1 Report 18, 27, 124-125 (Sept. 30, 2008).

21 TAS's evaluation of 20 Free File Sites revealed that only seven sites supported the benefits available to Hurricane Katrina victims. As a result, taxpayers using sites that have not incorporated late-enacted tax provisions into their free file product may be unknowingly overpaying their taxes by not claiming the tax benefits Congress specifically created for them. *See Tax Return Preparation Options: Hearing before the S. Comm. on Finance*, 108th Cong. 12-16 (2006) (Statement of Nina E. Olson, National Taxpayer Advocate).

22 For more information on obtaining and using tax data in time for the tax filing season, see Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights is Critical As the IRS Develops a Real-Time Tax System, infra/supra*; National Taxpayer Advocate 2011 Annual Report to Congress 288-290.

23 Advancing E-File Study Phase 1 Report 18, 27, 124-125 (Sept. 30, 2008).

24 GAO, GAO/GGD-97-6, Tax Administration: *Alternative Filing System* 1-3, 7, 8, 11, 13, 20, 41 (Oct 1996). Other countries use two alternative filing systems. In one, the "tax agency reconciliation system," the taxing authority prepares (or populates) the returns with information for the taxpayers. In the other type, the "return free" filing system, the taxpayer's income tax is withheld at the source and remitted to the taxing authority. It is also referred to as a "final withholding" filing system. Department of Treasury Report to Congress, *Return-Free Tax Systems: Tax Simplification Is a Prerequisite* 15 (Dec. 2003). For a discussion of electronic access to real-time transcript data and downloading third party data into an electronic return, *see* Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights is Critical As the IRS Develops a Real Time Tax System, infra/supra*. *See* also National Taxpayer Advocate 2004 Annual Report to Congress 471-477 (Key Legislative Recommendation: *Free Electronic Filing for All Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Key Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

GAO found at least 36 countries had adopted a "return free" tax system as an alternative approach to tax simplification.[25] GAO estimated that as many as 51 million U.S. taxpayers (or about 45 percent) of the 114 million filers in 1992 would not have had to prepare returns if the IRS had established a voluntary tax agency reconciliation system.[26] Taxpayers could have saved up to 155 million hours on tax preparation tasks and millions of dollars in return preparation fees,[27] while the IRS could have saved an estimated $15.1 million from not having to work over 850,000 underreporting cases.[28] In 1998, Congress directed the IRS to develop procedures for a "return free" system for appropriate individuals by 2007. The legislation stated:

> Not later than December 31, 2006, the Secretary of the Treasury or the Secretary's delegate shall develop procedures for the implementation of a return free tax system under which appropriate individuals would be permitted to comply with the Internal Revenue Code of 1986 without making the return required under section 6012 for taxable years beginning after 2007.[29]

The IRS is now five years overdue in complying with this statutory mandate.

The IRS should develop a secure, online portal (*i.e.*, electronic gateway) to a government-maintained database that would allow taxpayers to access information reported by third parties (*e.g.*, wages reported by employers on Forms W-2), as Congress directed it to do in 1998.[30] The legislation stated:

> Not later than December 31, 2006, the Secretary of the Treasury or the Secretary's delegate shall develop procedures under which a taxpayer filing returns electronically (and their designees under section 6103(c) of the Internal Revenue Code of 1986) would be able to review the taxpayer's account electronically, but only if all necessary safeguards to ensure the privacy of such information are in place.

This electronic access would greatly simplify return filing by allowing taxpayers to import third-party information directly into a government-provided electronic Form 1040 or tax

25 GAO, GAO/GGD-97-6, *Tax Administration: Alternative Filing System* 4 (Oct 1996); Department of Treasury Report to Congress, Return-Free Tax Systems: Tax Simplification Is a Prerequisite 7 (Dec. 2003).

26 A voluntary tax agency reconciliation system is equivalent to a pre-populated return.

27 GAO, GAO/GGD-97-6, *Tax Administration: Alternative Filing System* 4 (Oct 1996); Department of Treasury Report to Congress, Return-Free Tax Systems: Tax Simplification Is a Prerequisite 7 (Dec. 2003).

28 *Id*. at 2, 8, 20; Department of Treasury Report to Congress, Return-Free Tax Systems: Tax Simplification Is a Prerequisite 15 (Dec. 2003).

29 RRA 98, Pub. L. No. 105-206 title II, §2004, Pub. L. No. 105-206 title II, 112 Stat. 726 (Jul 22, 1998). *See* also OECD Forum on Tax Administration Taxpayer Services Subgroup, Survey of Trends and Developments in the Use of Electronic Services For Taxpayer Service Delivery 107 (Mar. 2010). If the IRS implemented an alternative tax system, such as the one taxpayers currently use in Spain, for example, U.S. taxpayers could opt for a pre-populated return by simply ticking a box on a government-provided electronic version of the Form 1040.

30 RRA 98, Pub. L. No. 105-206 title II, §2005, Pub. L. No. 105-206 title II, 112 Stat. 726 (Jul 22, 1998). National Taxpayer Advocate 2011 Annual Report to Congress 288-290. For a discussion of electronic access to real-time transcript data and downloading third party data into an electronic return, *see* Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights is Critical As the IRS Develops a Real-Time Tax System, infra/supra*. *See* also National Taxpayer Advocate 2004 Annual Report to Congress 471-477 (Key Legislative Recommendation: *Free Electronic Filing for All Taxpayers*).

preparation software of their choice. Many organizations (*e.g.*, employers and financial institutions) now allow taxpayers to import income information from their websites into commercial return preparation software. The government-provided form could also offer an additional safeguard against identity theft by limiting access to sensitive third-party information through a single, secure portal, rather than the multiple portals maintained by the third parties. This would limit taxpayers' exposure to a breach and reduce the risk of hackers stealing their personal information.[31]

Providing taxpayers with direct access to their data would also improve the accuracy of returns, freeing up increasingly scarce IRS resources for more return preparation assistance at TAC sites. It also would free up critical VITA and TCE resources for tax preparation in other areas, such as for low income small businesses and self-employed individuals.

TAC Sites Increasingly Turn Taxpayers Away, Directing them to Volunteers, Commercial Software, and Paid Preparers for Return Preparation Assistance.

Most Eligible Taxpayers Do Not Have Year-Round Access to Free Return Preparation Assistance at TAC Sites.

Free tax preparation help has never been more critical, yet because of limited IRS resources, only a small percentage of low-to-middle income taxpayers who need direct return preparation assistance now receive it from TACs. While the IRS provides year-round tax preparation services at these sites, where employees prepare current year returns as well as prior year amended returns for eligible taxpayers, the availability of these services is limited and declining due to budgetary constraints.[32] Return preparation is limited to certain days, which the IRS determines on a "TAC-by-TAC" basis. And beginning with the 2012 filing season, TAC sites no longer schedule appointments for return preparation.[33]

As shown in Figure 1.13.2, below, this reduction in direct services has nearly halved the number of e-filed returns accepted at TACs from approximately 129,000 in 2010 to less than 56,000 in 2012, even while the target population for services (*i.e.*, low income, elderly, disabled,) has remained steady, averaging 91 million in the 2010 through 2012 filing seasons (*i.e.*, tax years 2009 through 2011). In other words, TAC sites prepared electronic returns for slightly more than one tenth of one percent of the eligible taxpayers in 2010, and less than half that number in 2012.

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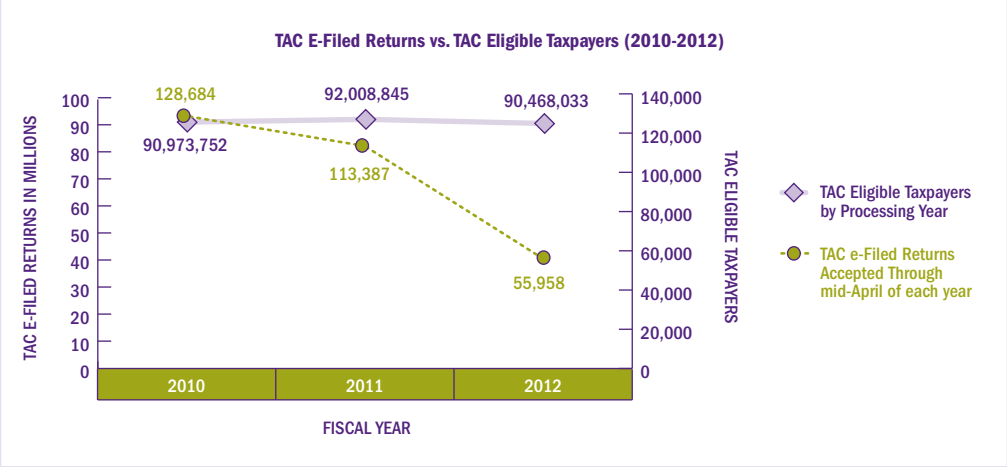
31 For a discussion of online services, see Most Serious Problem: *The IRS is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to be Done, infra/supra*.

32 SPEC FY 2012 Program Guide 1; IRS, Field Assistance, Taxpayer Assistance Centers (TAC) Services, 2012 Post Filling Season (Apr. 18, 2012). http://win.web.irs.gov/field/fadocs/TAC_Services_Post_Filing_Season_2012.pdf (last visited Aug. 8, 2012); See also, GAO-8-38, 2007, *Filing Season Continues Trend of Improvement, but Opportunities to Reduce Cost and Increase Compliance Should be Evaluated* 27-28 (Nov. 2007).

33 For an in-depth discussion of TAC operations, see Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra/supra*. For an in-depth discussion of SPEC and Stakeholder Liaison, see Most Serious Problem: *The IRS is Substantially Reducing Both the Amount and Scope of its direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of its Remaining Outreach Thereby Risking Increased Noncompliance, infra/supra*. For more information on obtaining and using tax data in time for the tax filing season, see Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights is Critical As the IRS Develops a Real-Time Tax System, infra/supra*.

FIGURE 1.13.2, Trend Comparison of TAC E-Filed Return v. Eligible Taxpayers, 2010–2012[34]



TAC sites increasingly are unable to meet the return filing needs of eligible taxpayers. Throughout the filing season, the IRS directs taxpayers with income of $50,000 or less to VITA sites, and taxpayers age 60 or older to TCE sites.[35] After the filing season, TAC employees direct taxpayers to a limited number of VITA and TCE sites that remain open throughout the year, which means that most eligible taxpayers do not have year-round access to free return preparation assistance. TAC employees also direct taxpayers to the Internet (*i.e.*, IRS Free File and IRS Free Fillable Forms) or commercial software, or encourage taxpayers to look for paid preparers.[36] Although there are many points for taxpayers to access services, the lack of clarity about which services are offered, and where and when, makes it difficult for many taxpayers to find the free services they need.

34 TAS Research, Compliance Data Warehouse, IRTF_F1040 table, FY 2010–2012, data drawn (Nov. 2, 2012), and IRS, Field Assistance E-File Reports (April 2010-2012). The IRS defines TAC eligible taxpayers as individuals filing Form 1040 series returns with AGI of $50,000 dollars or less. For an in-depth discussion of TAC Operations, *see* Most Serious Problem: *The IRS Lacks a Servicewide Strategy That Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services, infra/supra*.

35 IRM 21.3.4.10.2 (Apr. 18, 2012); IRM 22.30.1.5.1.1 (Oct. 1, 2011) *available at* http://win.web.irs.gov/field/fadocs/TAC_Services_Post_Filing_Season_2012.pdf (last visited July 25, 2012). VITA offers free return preparation and e-filing services to individuals with low-to-moderate income, seniors, Native Americans, individuals with disabilities, and those with limited proficiency in English. IRM 22.30.1.3.1 (Oct. 1, 2011). The IRS defines taxpayers as low to moderate income by reference to the threshold for claiming the Earned Income Tax Credit (*i.e.*, those with total income of $50,000, or less). See IRM 21.3.4.10.2 (Apr. 18, 2012). TCE authorizes the IRS to distribute grants under a cooperative agreement with eligible organizations that provide no-cost tax assistance to elderly taxpayers age 60 or older. Section 163, Revenue Act of 1978, Public Law No. 95-600, 92 Stat. 2810 (Nov. 6, 1978). *See also* IRM 22.30.1.3.1.3 (Oct. 1, 2011). For an in-depth discussion of SPEC and Stakeholder Liaison, see Most Serious Problem: *The IRS is Substantially Reducing Both the Amount and Scope of its direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of its Remaining Outreach Thereby Risking Increased Noncompliance, infra/supra*.

36 IRM 21.3.4.10.2 (Apr. 18, 2012). *See* IRS, Field Assistance TAC Services, 2012 Post Filing Season (Apr. 18, 2012). *See* http://win.web.irs.gov/field/fadocs/TAC_Services_Post_Filing_Season_2012.pdf (last visited Sept. 14, 2012).

The IRS is Attempting to Reach More Eligible Taxpayers Using Facilitated Self Assistance.

In response to the increasing need for return preparation services, the IRS developed the Facilitated Self Assistance (FSA) model to reach more taxpayers and help them become self-sufficient by incorporating taxpayer education into return preparation. IRS employees at certain TAC sites, and certified VITA/TCE volunteers, help taxpayers prepare their own returns, serving as facilitators and answering questions. This enables assistors to work with multiple taxpayers simultaneously. Taxpayers benefit by learning to use a computer to prepare their returns, and receive free online access to tax software from the FFA vendors.[37]

IRS research confirms that lack of access to computers and fast Internet connections is a significant barrier to taxpayers filing their own returns, and that an estimated 16 million more taxpayers would use FSA if the IRS made it more readily available.[38] To its credit, the IRS has worked closely with partners to identify the VITA and TCE sites best suited to the FSA model (*e.g.*, colleges and universities with "tech-savvy" populations that fall within the income limits of the program), pinpointing its marketing effort on "self-sufficiency and learning about taxes." In 2012, all 50 states had access to FSA software.[39] Although approximately 1,000 VITA/TCE sites applied for Site Identification Numbers (SIDN), only slightly more than 500 sites transmitted the more than 10,500 returns self-prepared in 2012.[40] Moreover, despite the reported success at these volunteer sites, the IRS has installed FSA capability at only 37 of its 401 TACs.[41] The IRS should accelerate the deployment of FSA terminals to its TACs and encourage more VITA/TCE sites to take advantage of them. This would improve services at TAC sites and produce the same benefits the IRS and taxpayers are realizing at some VITA/TCE sites (*i.e.*, the ability to help more taxpayers prepare returns, reduced wait times, access to free tax software, fast Internet connections, and help from experienced IRS employees).[42]

Assisting Taxpayers who Seek Direct Return Preparation Assistance Should Be a Central Component of IRS Service Delivery.

Many taxpayers in the target population for TAC return preparation assistance (*e.g.*, low income, elderly, disabled, and limited English proficiency) cannot wait long times to be served or be turned away. The IRS should adopt a policy that allows taxpayers to make

37 IRS Free File, *Alternative Filing Methods (FAST and Alternative VITA/TCE Site Model)* 8 (Aug 3, 2011). As of October 30, 2012, FFA offers services to 22 states that have cooperative free file programs. It also offers services to seven states that do not have a state income tax. *See* IRS response to TAS 7-day check for factual inaccuracies, Item 10 (Nov. 21 2012).

38 IRM 22.30.1.3.1.1.1 (Oct. 1, 2011); IRS Publication 4671, *VITA, Program Overview and Requirements* 3; SPEC, FY 2012 Program Guide 7. In FY 2012, the IRS expanded FSA capability to all 50 states. In FY 2011, taxpayers prepared more than 4,000 returns at over 100 sites. *See* IRS, Annual Report to Congress: *Progress on the Implementation of The Taxpayer Assistance Blueprint* 20-21 (Mar. 14, 2012). IRS Response to TAS Request for Information, Item 7 (Jul. 19, 2012).

39 SPEC FY 2012 Program Guide 6.

40 IRS response to TAS information request, item 7 (June 19, 2012). In 2011, approximately 400 sites applied for Site Identification Numbers (SIDN), with 106 sites reporting 4,200 self-prepared returns. In 2012, approximately 1,000 sites applied for SIDNs, with 504 sites filing 10,586 self-prepared returns.

41 GAO-12-176, *2011 Processing Gains, but Taxpayer Assistance Could Be Enhanced by More Self Service Tools* 18 (Dec. 2011).

42 IRS Publication 4907, *IRS Freefile Introduces Free Assisted Self-Service Tax Preparation* (Dec. 2010).

appointments and accepts walk-in customers for FSA or direct return preparation assistance. Terminals could be reserved and experienced employees could serve as "floaters," attending to taxpayers as they arrive.[43]

The National Taxpayer Advocate applauds the outstanding work of the many dedicated volunteers who serve each year preparing returns, but remains concerned about the IRS's continuing shift away from assisting taxpayers who want direct IRS help. VITA sites are stretched to their limits and the IRS does not provide nearly enough support and oversight to its volunteer programs to ensure accuracy and confidentiality. Moreover, the IRS itself has imposed limitations on what volunteer programs can do. For example, the IRS directed VITA sites not to handle returns for taxpayers in the region where Hurricane Katrina struck, presumably because it believed the returns would be too complex for volunteers to prepare accurately.[44] Improving customer service, as well as enforcement, is essential to achieving a high rate of compliance. Assisting taxpayers who seek help computing their tax liabilities and preparing their returns should continue to be a central component of taxpayer service.

The IRS Relies on VITA for Return Preparation But Continues to Give Inaccurate or Incomplete Information About Site Locations, and Provides Tax Software Embedded with a Costly Commercial Product.

IRS Employees Have Provided Inaccurate or Incomplete Information About VITA Sites to Callers for Nearly a Decade.

The IRS's growing reliance on volunteers allows it to serve more taxpayers with fewer employees.[45] However, the Treasury Inspector General for Tax Administration (TIGTA) has repeatedly addressed concerns about the way IRS telephone assistors provide VITA site information to taxpayers. TIGTA reported that assistors at 45 percent of IRS call sites tested provided inaccurate information[46] that did not always include accurate site locations, hours of operation, and services offered for 33 percent of VITA sites.[47] TAS's own evaluation of the services provided by IRS assistors revealed that they continue to give taxpayers incomplete information about VITA. For example, the IRS did not provide information about site accessibility in nearly 90 percent of the calls, and did not provide language availability at VITA sites nearly 60 percent of the time.[48] This shows that the IRS is failing to

43 For an in-depth discussion of TAC operations, see Most Serious Problem: *The IRS Lacks a Serivcewide Strategy that Identifies Effective and Efficient Maens of Delivering Face-to-Face Taxpayer Services, infra/supra*.

44 *Tax Return Preparation Options: Hearing Before the S. Comm. on Finance*, 108th Cong. 5 (2006) (Statement of Nina E. Olson, National Taxpayer Advocate).

45 SPEC FY 2012 Program Guide 3.

46 TIGTA, Ref. No. 2006-40-004, *Significant Improvements Have Been Made in the Oversight of the Volunteer Income tax Assistance Program, but Continued Effort Is Needed to Ensure the Accuracy of Services Provided* 3, 17, 22 (Nov. 2005).

47 TIGTA Ref. No. 2006-40-125, *Oversight and Accuracy of Tax Returns Continue to Be Problems for the Volunteer Income Tax Assistance Program* 18, 21 (Aug. 31. 2006).

48 TAS, VITA Site Survey (April 2012). TAS made 398 calls to the VITA Assistance Line from mid-March to mid-April, 2012. We recorded how long assistors took to answer calls, and whether they provided complete and accurate VITA site information (*e.g.*, nearest site location, days and hours of operation, site accessibility information for taxpayers with disabilities, foreign language services for taxpayers with limited proficiency in English, *etc.*). The survey results are statistically valid for the timeframe sampled at a 95 percent confidence level, and a margin of error no greater than +/- 4.86 percent.

assist taxpayers by not giving them the information to determine whether services are actually available. The IRS also may not have all the current information about each VITA site. This failure is significant because the IRS is using VITA and TCE as the primary points of face-to-face return preparation.

Tax Software the IRS Provides to VITA/TCE Organizations Contains an Embedded Commercial Debit Card Product that Imposes Costly Fees.

The private sector plays an important role in tax administration, but there is a need for greater standardization and control over the content of commercial tax software for consistency, and to avoid potential conflicts of interest. In the 2011 filing season, almost all of the roughly 12,000 VITA and TCE sites offered debit cards to taxpayers with refunds.[49] Although the IRS claims that it does not endorse any one commercial product over another, the software it provides to VITA and TCE sites — CCH *TaxWise* — contains an embedded Western Union product that charges fees for using the debit cards used to issue refunds (*e.g.*, for ATM cash withdrawals) that are higher than the fees charged by some of its competitors.[50]

The National Taxpayer Advocate raised this issue in her 2011 Annual Report to Congress. However, the IRS has not taken action to protect taxpayers. The incorporation of the Western Union Money Wise prepaid card in the TaxWise software the IRS provides to VITA and TEC sites free of charge creates an unfair advantage, and essentially represents an indirect endorsement of this product by the IRS. When the National Taxpayer Advocate first raised the issue, the IRS represented that the debit card feature had not been incorporated into the software at the time the IRS entered into the contract with CCH. The National Taxpayer Advocate urged the IRS to eliminate all references to the commercial product in the TaxWise software, but CCH has yet to remove the product. The TaxWise monthly activity report the IRS receives from CCH has revealed that over 4,000 taxpayers using VITA have purchased the product. The National Taxpayer Advocate, again, urges the IRS to avoid any appearance of a conflict of interest by renegotiating the contract agreement with CCH and demanding that CCH remove the Western Union product from TaxWise.[51]

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49 GAO-11-481, 2011, *Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance* 31 (March 2011).

50 *See* IRS response to TAS information request, Item 12 (June 19, 2012). The IRS does not require VITA/TEC sites to use the software it provides (TaxWise); however, it prohibits VITA/TCE grant recipients from using grant funds to purchase other commercial tax software. *See also* IRS response to TAS 7-day check for factual inaccuracies, Item 18 – Prepaid Card Comparison (Nov. 21 2012).

51 National Taxpayer Advocate 2011 Annual Report to Congress 405, 410, 413, 417-418. For a detailed discussion of the debit cards, see Most Serious Problem: *A Proactive Approach to Developing a Government-Issued Debit Card to Receive Tax Refunds Will Benefit Unbanked Taxpayers*, *infra/supra*.

CONCLUSION

The National Taxpayer Advocate preliminarily recommends that the IRS:

- Develop a government-provided electronic version of the Form 1040 that allows taxpayers to e-file all 1040 series forms and schedules, with computational capability and with links to forms, instructions, related worksheets, and publications.
- Develop a portal to a government-controlled database from which taxpayers can import third-party data.
- Allow taxpayers to make appointments for return preparation, and accommodate walk-in customers.
- Accelerate the deployment of FSA terminals to TACs, and encourage more VITA and TCE sites to use them.
- Reassess procedures for maintaining VITA site information and for ensuring assistors provide the information callers need to access services, and implement measures to improve accuracy.
- Renegotiate the contract with CCH to remove the Western Union debit card product from the TaxWise software, and solicit competitive bids for a debit card product.

IRS COMMENTS

The IRS supports the goal of ensuring no-cost filing alternatives for taxpayers in need of such services to meet their filing obligations. The IRS does this in many different ways. In a limited fashion, the IRS is able to provide these services directly in its Taxpayer Assistance Centers. The IRS has added Facilitated Self-Assistance to many TAC locations to further support taxpayers and is piloting Virtual Service Delivery. The IRS is able to support a greater number of taxpayers through its partnerships with VITA sites and TCE sites. To expand free self-return preparation access to the more than 16 million taxpayers who qualify for free tax preparation services, the IRS developed and implemented its FY 2013 Alternative Filing Strategy which includes a *"You Choose"* model where partners and taxpayers select between eight vendors to deliver free self tax preparation services at a virtual or physical location. The IRS continually evaluates these methods and emerging ideas for providing low-income taxpayers with no cost alternatives for meeting their tax return filing obligations.

TACs. Delivering excellent customer service is a priority of the IRS. The TACs are one of the vital resources available to taxpayers. TAC assistors provide a variety of services to taxpayers who visit the 397 TAC locations throughout the country. The TAC program provides face-to-face assistance to taxpayers who cannot resolve their problem over the telephone or through correspondence, need a document issued to them in a reasonable period of time, or prefer face-to-face contact. In FY 2012, this type of live assistance was provided to seven million taxpayers.

As noted above, the IRS is able to provide these free tax preparation services for a limited number of taxpayers directly in its TACs. Specifically, TAC sites prepare tax returns for walk-in clients several days per week throughout the year on a first-come, first-served basis. Appointments are available to taxpayers with special needs, such as those with disabilities, at the discretion of local TAC management, although return preparation is generally offered on a first-come, first-served basis each day until capacity is reached. The IRS has concluded that the scheduling of appointments for return preparation would reduce resources available to provide services to taxpayers who are awaiting other services that only the IRS can provide.

FSA. As also noted above, the IRS has added FSA to many TAC locations to further support taxpayers and is piloting VSD. FSA is a new approach that incorporates tax education into the tax preparation process. Certified volunteers assist taxpayers in preparing their own returns. Since the role of the volunteer is that of a teacher or facilitator, multiple taxpayers can be assisted simultaneously. In a limited resource environment, this model can provide expanded access to additional taxpayers at minimal cost to the IRS. For FY 2012, all 50 states will have access to software for an FSA site. The IRS has developed a partnership with the Department of Education to promote and provide outreach to an estimated four million college students, parents, and educators on FSA. Additionally, the IRS is collaborating with other federal agencies, the military, and educational and faith-based institutions to promote FSA. The targeted audience is for taxpayers that meet VITA requirements but cannot access a traditional site or do not need one-on-one assistance. This year, more than 210 employees have been trained on all aspects of FSA to ensure successful implementation. The additional trained staff allows IRS to provide more hands-on guidance to taxpayers and partners as they use the new tools at alternative filing sites. The IRS will continue to seek funding to expand FSAs to additional TACs.

VSD. During FY 2012, the IRS completed the VSD pilot in the TACs, and it was deemed successful serving almost 17,000 taxpayers through the end of September. The report showed that the vast majority (87 percent) of taxpayers using VSD reported that they received resolution for their main issue. An even larger number of respondents (91 percent) reported that they would be willing to use video assistance again during a future visit. The IRS will be expanding the VSD program in FY 2013. Planning is underway to deploy virtual service in six TACs and six partner sites for the 2013 filing season.

Referral to VITA/TCE. When TAC assistors are unavailable to prepare returns during the days offered and FSA or VSD do not meet sufficiently the needs of a taxpayer, TAC employees will educate that taxpayer on all other free filing options. These options include directing taxpayers to local IRS-sponsored VITA sites or TCE sites and to other available free electronic filing options (IRS Free File and IRS Free Fillable Forms) that could possibly reduce their time waiting for return preparation services in TACs. Many VITA and TCE sites receive grants from the IRS to prepare returns with the low-income, elderly, disabled, and those that speak limited English, with some open year-round.

The IRS has reassessed procedures for maintaining VITA site information and for ensuring assistors provide the information callers need to access services, and implement measures to improve accuracy. In 2012, the IRS released the *VITA locator* available on IRS.gov. This tool, which has been shared with IRS phone assistors, allows assistors and taxpayers to locate available VITA sites within the taxpayer's community. External VITA and TCE partners share data with the IRS concerning the availability of their sites during and after the filing season. This ensures that site information such as locations and hours of operation are timely updated on the IRS.gov VITA Site Locator, a new online tool that allows assistors and taxpayers to locate available VITA sites within the taxpayer community. The tool is updated twice per week to ensure that new information is recorded in a timely manner. Providing this information informs taxpayers regarding free tax preparation services available in their respective communities.

For many years, IRS has partnered and financially supported the development of VITA and TCE sites around the country to ensure that there are sufficient no cost tax preparation services. In these settings, the IRS trains volunteers who become certified to prepare taxpayer returns in face-to-face meetings using a standard intake sheet, interview and quality review process. Last year, VITA and TCE volunteers prepared returns with a 92 percent rate of accuracy. Recently, we have developed, through the expanded use of technology, Virtual VITA and TCE, which functions in the same manner except that modern technology is used to connect the volunteer and the taxpayer in lieu of an in person meeting. Technology typically includes broadband Internet, fax, and video conference. Although this may be more necessary in remote locations where it is difficult to find a traditional VITA/TCE site, the approach can also be expanded in urban settings to supplement traditional VITA/TCE assistance.

With respect to the Western Union debit card product from the TaxWise software, we do not endorse any commercial financial product offered by VITA/TCE partners. As we noted in last year's Annual Report, TaxWise did not include a debt card feature at the time the IRS entered into a software contract with this provider. The debit card feature will not be available for use during the TY 2012 filing season. The new 2014 contract will also include a prohibition on offering a debit card product in software purchased by the IRS.

Finally, and very importantly, the IRS has never denied service to any disaster area or directed volunteers to discontinue tax preparation services in a disaster area. The MSP incorrectly asserts that "IRS directed VITA sites not to handle returns for taxpayers in the region where Hurricane Katrina struck, presumably because it believed the returns would be too complex for volunteers to prepare accurately." The IRS firmly believes that VITA and TCE sites offered tax preparation service to Katrina victims and should and will continue to provide such services to any qualifying taxpayer within the scope of the VITA/TCE program, regardless of location.

Free File Alliance. The IRS provides Free File Fillable Forms (FFFF) through its public partnership with the Free File Alliance. The Free File program supports 70 percent of taxpayers using an income threshold to ensure that this goal is achieved. No member of the Free File Alliance is allowed to make its free offer available to more than 50 percent of this population to promote and ensure adequate market competition among the members of the Free File Alliance. The Free File Alliance ensures that there is at least one offer listed on IRS.gov for eligible taxpayers to file their return. There are no gaps in coverage for qualified taxpayers. Free File Fillable Forms, which is accessed from IRS.gov, represents an electronic version of the paper Form 1040. IRS publications and instructions are included with the FFFF program.

The IRS provides a government-provided electronic version of the Form 1040 through its public and private partnership with the Free File Alliance. IRS publications and instructions are included with the Free File Fillable Forms program. As currently developed, there is no cost to the federal government for software development and maintenance.

In 1998, Congress recommended in Public Law 105-206 that the IRS cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns. In 2003, the Treasury Department issued *Report on Return Free Tax Systems: Tax Simplification is a Prerequisite* as requested under the 1998 statute. The report found "that moving to a return-free tax system without first simplifying the income tax code would require substantive changes in tax administration. Added burden would be placed on employers and other payers of income who would be required to accelerate reporting of W-2s and 1099s, and the IRS and SSA would have to speed up the processing and editing of these income reporting documents to avoid significant delays in refunds."

In April 2007, the GAO published the report, *Taxpayer Services State Experiences Indicate IRS Would Face Challenges Developing an Internet Filing System with Net Benefits.* The study reported that states with direct state filing systems showed low usage.

The development, delivery, and support of software to a broad market is already in place in the private industry. In 2012, IRS reached a milestone of achieving the 80 percent e-file objective for 1040 returns through its strong partnership with private industry.

With respect to the concerns expressed regarding Free File, taxpayers give Free File high customer satisfaction ratings. According to a 2009 survey by Russell Research, 95 percent of taxpayers using Free File intended to use the program the following year. Ninety-eight percent would recommend Free File to others, and 96 percent would recommend Free File Fillable Forms to others. Also, according to Russell Customer Satisfaction survey, 97 percent of those surveyed found the process of selecting a free file company either Very Easy or Somewhat Easy. In 2012, IRS took additional steps to simplify the offers by making the information easier to understand. Additionally, taxpayers may find the company that works best for them by selecting the IRS created interactive tool, *Help me choose a*

company at www.IRS.gov/freefile. By answering a few simple questions, the application narrows the number of companies available to meet that taxpayer's needs.

In addition, there are a number of examples where the Free File Alliance has stepped up to meet urgent requests of IRS and the needs of the American taxpayer as a result of late-passed congressional tax legislation.

1. In 2008, taxpayers who normally did not have to file a tax return could use Free File to receive their 2008 Economic Stimulus Payment. Many Free File companies updated their software in time to offer free taxpayer assistance for claiming their $300 (individuals) or $600 (married couples) Economic Stimulus Payment.
2. Under the Mortgage Forgiveness Debt Relief Act of 2007, enacted December 20, 2007, taxpayers could exclude debt forgiven on their principal residence by filing Form 982. Many of the Free File companies updated their programs based on late legislation to allow taxpayers to e-file Form 982 for free. Free File added this capability and met IRS needs to start e-filing Form 982 returns as soon as IRS started accepting them in March of 2008.
3. In 2011, late tax law changes resulted in the IRS needing extra time to update its systems as a result of the December 17, 2010 enactment of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. This Act extended a number of expiring provisions, including state and local sales tax, higher education tuition and educator expenses deductions. As a result, the IRS could not start accepting Form 1040 *Schedule A, Itemized Deductions*; Form 8917, *Tuition and Fees Deduction;* and the Education Expense deduction on Form 1040 (line 23) until February 14, 2011. To minimize taxpayer burden, the Free File Alliance updated software at the start of the filing season to allow taxpayers to prepare their returns. These companies stored the returns and began submitting them after February 14, 2011, the date that the IRS could accept the denoted forms and fully process the returns.

We are appreciative of these kinds of benefits that are created through the synergies of our well-established public-private partnership with the Free File Alliance at the same time that we are able to make available a free filing option to 70 percent of all taxpayers required to file federal tax returns.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS recognizes the need for no-cost filing alternatives to improve voluntary filing compliance, and that TAC sites should make it a priority to deliver excellent customer service. We agree that the TACs play a vital role helping the low and middle-income taxpayers who prefer to visit the IRS in person to satisfy their filing obligations. We commend the IRS for the inroads it is making in using Facilitated Self-Assistance to encourage and assist taxpayers who seek to become more self-reliant, by integrating tax education with return preparation assistance. We are encouraged by the Virtual Service Delivery pilot program and commend the IRS for making the software accessible in all 50 states in FY 2012. We also hope to see the IRS realize VSD's full potential in bridging the geographical divide that now prevents taxpayers in outlying rural areas from accessing the free services they need, by using it to increase direct return preparation assistance at TACs and volunteer sites in 2013.

However, the National Taxpayer Advocate is disappointed that the IRS has concluded it cannot afford to schedule appointments at the TACs for taxpayers who ask the IRS for help in preparing their returns. The IRS says it has chosen to serve only a limited number of taxpayers because to do otherwise would reduce the resources available for taxpayers who need "other" services that "only the IRS can provide." The implication here seems to be that delinquent taxpayers with balance due accounts and taxpayers who have not filed delinquent returns are more important than those who are trying to remain compliant. We understand the IRS is struggling to reach as many taxpayers as it can, with limited resources, and that "in extreme or emergency circumstances, Group Managers will have the discretion to authorize the preparation of returns."[52] However, we believe this approach is shortsighted and counterproductive, and that a better approach would be to allocate more resources to helping compliant taxpayers prepare their returns, by providing appointments for those who request them, and by offering return preparation to walk-in taxpayers. Improving both customer service and enforcement is essential to achieving a high rate of compliance. We continue to believe that assisting taxpayers who seek help computing their tax liabilities and preparing their returns should be a central component of taxpayer service and that the IRS needs to do more to satisfy the needs of these taxpayers.

The IRS contends that it has reassessed the procedures for maintaining VITA site information, and for ensuring that its telephone assistors provide callers the information they need to access VITA services. The National Taxpayer Advocate is pleased that the IRS has installed a new online locator tool (which the IRS indicates is updated twice weekly) that allows taxpayers and assistors to find VITA sites in their communities, and that VITA and TCE volunteers prepared returns with a 92 percent accuracy rate during the 2012

52 FY 2012 Return Preparation in Taxpayer Assistance Centers (TACs), Field Assistance 6 (Jan. 23, 2012).

filing season.[53] However, we remain concerned that the IRS has elected not to address the findings from TAS's own evaluation of the services provided by telephone assistors, which revealed that in 2012 assistors failed to provide site accessibility information in 90 percent of the calls, and failed to provide language availability at VITA sites nearly 60 percent of the time.[54] We believe that while updating the locator on the IRS website is critical, it is not enough. Assistors responding to callers must convey the site information as well and, therefore, it seems clear they are not using the new locator tool correctly. The IRS should make it a requirement to use the locator, and should perform quality reviews, including checking the contact recordings, to make certain assistors are providing complete and correct information. The IRS has not addressed this failure in its response.

The National Taxpayer Advocate is pleased that the IRS plans to adopt the recommendation we made in the 2011 Annual Report to remove the Western Union debit card product from its TaxWise software. We applaud the IRS for this step and look forward to reviewing the TY 2012 software and 2014 licensing agreement.

The IRS asserts that it has never denied service to any disaster area or directed volunteers to discontinue tax preparation services in a disaster area, and that it "...firmly believes that VITA and TCE sites offered tax preparation service to Katrina victims and should and will continue to provide such services to any qualifying taxpayer within the scope of the VITA/TCE program, regardless of location." As we have reported, when the National Taxpayer Advocate testified before Congress, in April of 2006, she stated "The IRS must remain open for business to taxpayers who seek assistance from the government in preparing their returns," noting, "...the IRS directed VITA sites not to prepare returns in the zone where Hurricane Katrina struck, presumably because it believed the returns would be too complex for volunteers to prepare accurately." In late 2005, the IRS reported that it had contemplated working casualty losses at its volunteer sites, but the complexity of the law in this area posed a significant risk to the quality of services that volunteer preparers could provide, and that they would not complete these returns (*i.e.*, "Casualty losses are out of scope for the entire VITA program.").[55]

The IRS contends that it provides an electronic version of Form 1040 through its agreement with the Free File Alliance (*i.e.* Free File and Free Fillable Forms), and that there are no gaps in this delivery system for "qualified" taxpayers. However, we believe the existing system needs improvement. It does not support electronic filing for all forms and schedules in the 1040 series, does not leverage the computational capability of today's computers,

53 TIGTA, Ref. No. 2012-40-088. *Ensuring the Quality Review Process Is Consistently Followed Remains a Problem for the Volunteer Program: Highlights* 1 (July 27, 2012).

54 TAS, VITA Site Survey (April 2012).

55 *Tax Return Preparation Options: Hearing Before the S. Comm. on Finance*, 108th Cong. 5 (2006) (Statement of Nina E. Olson, National Taxpayer Advocate); Hurricane Katrina National Partner Conference Call, Speaker Notes 4 (Nov. 29, 2005); SPEC Nationwide Hurricane Katrina Conference Call, Minutes 3 (Oct. 26, 2005); Alert: AM IMF/BMF 07057, Scheduling pro-bono assistance for taxpayers affected by Hurricanes Katrina, Rita and Wilma (Nov. 22, 2007). The IRS reported that it would no longer be taking referrals for scheduling *pro bono* assistance due to Hurricanes Katrina, Rita, and Wilma, noting that all VITA sites have closed with the passing of the October 16 extension deadline. CARE no longer has the ability to refer these requests to the practitioner community. "If taxpayers or their representatives request assistance, please advise them this assistance is no longer available."

with fillable worksheets that could transfer computations to the fillable forms, and is not currently available to 100 percent of U.S. taxpayers. As we explained in the report, and as the National Taxpayer Advocate stated in her 2006 testimony, the government should make it possible for *all* taxpayers — not just "qualified" taxpayers — to file their returns electronically without having to pay a fee.[56] If the IRS developed a government-provided electronic version of the Form 1040 — that would allow taxpayers to e-file any of the1040 series forms and schedules, with computational capability and with links to forms, instructions, worksheets, and publications — all individual taxpayers could prepare and e-file their returns for free.

Finally, the IRS asserts that, in 1998, Congress recommended that it cooperate with the private sector, and encourage competition to increase electronic filing, and that moving to a return free tax system without first simplifying the tax code would require substantive changes in tax administration. However, the National Taxpayer Advocate would point out that, at the same time, in the same law, Congress required the IRS to develop a return free tax system. Moreover, given that we are now discussing the need for accelerated, real-time, tax information for fraud prevention, as well as for improved accuracy, the National Taxpayer Advocate believes the IRS has presented a feeble, archaic, response, one grounded in 20th Century tax administration and technology.

Recommendations

In conclusion, the National Taxpayer Advocate recommends that the IRS:

1. Develop a government-provided electronic version of the Form 1040 that allows taxpayers to e-file all 1040 series forms and schedules, with computational capability and with links to forms, instructions, related worksheets, and publications.
2. Develop a portal to a government-controlled database from which taxpayers can import third-party data.
3. Allow taxpayers to make appointments for return preparation at TACs, and accommodate walk-in customers.
4. Accelerate the deployment of FSA terminals to TACs, and encourage more VITA and TCE sites to use them.
5. Continually reassess procedures for maintaining VITA site information and ensuring that telephone assistors provide the information callers need to access services, and implement measures to improve accuracy, including requiring IRS phone assistors to use the VITA Site Locator and monitoring accuracy through quality review and contact recording.

56 *Tax Return Preparation Options: Hearing Before the S. Comm. on Finance*, 108th Cong. 2 (2006) (Statement of Nina E. Olson, National Taxpayer Advocate).

MSP #14

The IRS is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to be Done

RESPONSIBLE OFFICIAL

Rajive Mathur, Office of Online Services

DEFINITION OF PROBLEM

Taxpayers increasingly use online services to perform a variety of tasks in their daily lives, including financial transactions. Surveys show that the average U.S. taxpayer spends approximately 15.5 hours per week using the Internet.[1] In addition, approximately 30 percent of U.S. taxpayers use mobile Internet services for advanced activities, including mobile banking, at least monthly.[2]

The IRS is striving to meet this growing demand by creating more online products. The Office of Online Services (OLS) is responsible for developing technology for taxpayers, practitioners, and IRS employees across a variety of channels, including the traditional web, mobile technology, and social media. We commend the IRS for establishing this office, which has a clear mission with a research-based strategy to meet taxpayer demand in incremental steps.[3] The organization has had success with the development and enhancement of several taxpayer assistance applications, including IRS.gov, various calculator tools, and other popular applications such as "Where's My Refund."[4]

We applaud the IRS, specifically the Office of Online Services, for the development of popular self-assistance tools as well as a research-based strategy to meet the needs of taxpayers and tax administration. However, we believe the IRS still has a long way to go to provide taxpayers with the types of services they demand and are accustomed to receiving from other sources. For example, the IRS would benefit from an online account access program that would initially allow taxpayers to view the status of their accounts and eventually enable them to interact directly with the IRS. While such projects involve upfront development and implementation costs, the IRS would realize savings in the short term from decreased call volume and in the long term from improved tax compliance and a reduction in costly enforcement contacts for basic issues.

1 Forrester Research, The Taxpayer Advocate Service: Omnibus Analysis, From North American Technographics Omnibus Mail Survey, Q2 2011, Slide 23 (Dec. 22, 2011). The study defined U.S. taxpayers as U.S. consumers aged 18 years or older.

2 *Id.*, Slide 36 (Dec. 22, 2011). In a more specific survey question, approximately 12 percent of U.S. taxpayers responded that they check financial accounts on their primary cell phone or handheld wireless device at least monthly. Forrester Research, The Taxpayer Advocate Service: Omnibus Analysis, From North American Technographics Omnibus Mail Survey, Q2 2011, Slide 38 (Dec. 22, 2011).

3 IRS Office of Online Services, IRS Online Strategy 7 (Sept. 2012).

4 A complete list of tools for individual taxpayers can be found at http://www.irs.gov/uac/Tools?portlet=105 (last visited Nov. 8, 2012).

ANALYSIS OF PROBLEM

Background

The Office of Online Services treats each current or potential service as a business. In consultation with the appropriate IRS function(s), OLS identifies the taxpayer demand, segments the audience, assesses the impact of the service on existing IRS processes, develops the design, priority, and a roadmap, creates a launch pad and marketing plan, and measures results.[5] OLS has a five-year strategy to enable taxpayers to get everything they need online. Specifically, the strategy aims to allow taxpayers to do the following, launched in incremental steps over the next five years:

- Correspond with the IRS digitally, such as through secure messaging and live chat;
- Easily search for actionable information on basic tax questions through IRS.gov;
- Access all online services through mobile technology;
- Make all payments online;
- Access account-related information, such as viewing transcripts and tracking amended return status, through online self-service tools;
- Manage all tax forms electronically; and
- Leverage third-party tools.

OLS initially focused on IRS.gov and mobile technologies, and improving the content and search capabilities of the website. The office sets priorities for new online self-help services based on taxpayer needs balanced with IRS business needs, the complexity of transactions, time-to-market, and cost of the project. Recently developed and revised applications include eTranscripts;[6] Where's My Refund, Filing Season 2012;[7] VITA Site Locator;[8] First-

5 IRS Online Services, Governance Kickoff 3 (Nov. 29, 2011).

6 Application enables individuals to order an account or return transcript online. The application's effectiveness and efficiency is limited by the fact that the transcript currently cannot be emailed to the taxpayer and instead must be mailed to the address on record for the taxpayer. See http://www.irs.gov/Individuals/Order-a-Transcript (last visited Dec. 21, 2012).

7 Where's My Refund was enhanced for Filing Season 2012. In general, the application enables taxpayer to check the status of a refund. See http://www.irs.gov/Refunds/Where's-My-Refund-It's-Quick,-Easy,-and-Secure (last visited Dec. 21, 2012).

8 The VITA Site Locator provides taxpayers with the location of a Volunteer Income Tax Assistance (VITA) or Tax Counseling for the Elderly (TCE) site within the stated parameters provided by the taxpayer. The tool provides address, phone number, languages spoken, hours, and appointment requirements. See http://irs.treasury.gov/freetaxprep/ (last visited Dec. 21, 2012).

Time Homebuyer Credit Account Look-up;[9] Mobile m.irs.gov;[10] and IRS2Go Revision 2.[11] Other projects in various stages of development include:[12]

1. Improved video content on IRS.gov;[13]
2. "Where's My Amended Return;"[14]
3. "What's My Name;"[15]
4. File and Pay Forms 941/944;[16]
5. Pay by ACH Debit or Debit Card;[17]
6. Offer in Compromise (OIC) Pre-Qualifier;[18] and
7. Communication and Document Exchange.[19]

Finally, while we commend the IRS for moving in the right direction by broadening its online service offerings, the National Taxpayer Advocate continues to believe that there are certain categories of service that are better handled face-to-face. First, certain taxpayers are not comfortable using online services and the IRS should meet their needs, especially the elderly and low income taxpayers. Second, taxpayers have indicated a preference for face-to-face or telephone service delivery for tasks that require judgment or interactive communications, such as responding to notices.[20]

The IRS is Moving Toward the Vision of Electronic Service Delivery Set Forth in the Taxpayer Assistance Blueprint.

In response to a congressional mandate in 2005, the IRS delivered to Congress in 2007 the Taxpayer Assistance Blueprint (TAB) Phase 2 report, a five-year strategic plan for improving taxpayer services. The Taxpayer Assistance Blueprint team conducted extensive research

9 The First-Time Homebuyer Credit Account Look-up application allows taxpayers to see the total credit received, the balance, amount repaid to date, and the annual installment repayment amount. See http://www.irs.gov/Individuals/First-Time-Homebuyer-Credit-Account-Look-up (last visited Nov. 8, 2012).

10 Mobile m.irs.gov enables taxpayers to use any mobile browser to access IRS.gov. IRS Online Services, Governance Kickoff 6 (Nov. 29, 2011).

11 IRS2Go Revision 2 includes updates to the smartphone application that allows taxpayers to check refund status, order transcripts and get video updates. See IRS, *New IRS2Go Offers Three More Features, available at* http://www.irs.gov/uac/New-IRS2Go-Offers-Three-More-Features (last visited Nov. 8, 2012).

12 IRS Online Services, Governance Kickoff (Nov. 29, 2011); IRS, Office of Online Services, IRS Online Strategy (Sept. 2012).

13 This enhancement of IRS.gov will enable taxpayers to access video on IRS.gov search results and will develop additional video content on IRS.gov to support high-traffic informational queries. IRS Online Services, Governance Kickoff 6 (Nov. 29, 2011).

14 This application will enable a taxpayer to check the status of an amended return filing. *Id*.

15 The application would allow an individual or business taxpayer to check their official name on record. *Id*.

16 This application would allow business taxpayers to file Forms 941 and 944 on IRS.gov and pay in one step. *Id*. at 6 (Nov. 29, 2011).

17 This application would allow taxpayers to easily make a payment on the IRS website using ACH Debit or debit cards. *Id*.

18 This is a basic interactive calculator to assist taxpayers in determining eligibility for an Offer in Compromise prior to calling a customer service representative. *Id*. While the National Taxpayer Advocate is generally supportive of this application, the devil is in the details. The success of this application depends on the IRS programming appropriate questions into the program, so that low income and middle income taxpayers, and small business taxpayers, are not discouraged from submitting an offer because the application projecting payment amounts that would be much lower if the taxpayer spoke to an IRS assistor.

19 This application would enable taxpayers and the IRS to interact electronically by communicating as well as sending and receiving documents. *Id*.

20 IRS Publication 4579, 2007 Taxpayer Assistance Blueprint Phase 2, 44 (Apr. 2007), *available at* http://www.irs.gov/pub/irs-pdf/p4579.pdf (last visited Aug. 6, 2012).

on the needs, preferences, and behaviors of individual taxpayers. The data indicated that individual taxpayers generally prefer self-assisted services, such as those found on the IRS website, for transactional tasks. However, the data also showed that taxpayers preferred assisted services, such as those available on the telephone or in-person at Taxpayer Assistance Centers (TACs), for more complex interactive tasks like responding to a notice. Telephone and Internet service channels accounted for more than 85 percent of all taxpayer contacts with the IRS, especially with respect to tax refund account inquiries and responses to notices. Thus, the TAB envisioned an IRS that is an "interactive and fully integrated, online tax administration agency" with the capability "for any exchange or transaction that currently occurs face-to-face, over the phone, or in writing to be completed electronically."[21]

In a 2011 follow-up survey (the TAB Conjoint Update), participants clearly preferred to use the website, either browsing or using an interactive tool, for each of the following needs:

1. Getting a form or publication;
2. Getting information about a notice they received;
3. Getting assistance determining tax credits and deductions;
4. Getting prior-year return information;
5. Making a payment or setting up a payment plan;
6. Checking the status of a transaction; and
7. Getting help making tax-related calculations.[22]

It is clear that the IRS is working toward the goal of providing more self-assist tools for taxpayers. However, the IRS and OLS have a long way to go to achieve the vision in the TAB Phase 2 Report as well as meeting all the taxpayer preferences in the 2012 TAB Conjoint Update. What is noticeably absent is the ability of taxpayers to manage their tax accounts online: to see the status of their accounts and resolve appropriate compliance issues electronically.

The IRS Can Learn from the Electronic Service Delivery Experiences of Other International Revenue Bodies.

A 2009 survey conducted by the Centre for Tax Policy and Administration of the Organization for Economic Co-Operation and Development (OECD) provided insights on overall trends, progress, and likely directions of revenue bodies around the world with respect to electronic services for taxpayers. Most of the surveyed revenue bodies gave primary emphasis in their plans to reducing taxpayer compliance burden, with improved

21 IRS Publication 4579, 2007 Taxpayer Assistance Blueprint Phase 2, Executive Summary 2-4, 35 (Apr. 2007), *available at* http://www.irs.gov/pub/irs-pdf/p4579.pdf (last visited Aug. 6, 2012). The TAB also acknowledged that some taxpayers will continue to require in-person or telephone assistance. *Id*. at 5 ("Low income, LEP, and elderly taxpayers tend to report a somewhat higher preference for the TAC channel and a lower preference for the electronic channel than the majority of taxpayers as a whole.").

22 Wage and Investment Research & Analysis, TAB Conjoint Update: Final Report for Wage and Investment Research and Analysis Director, Project No. 2-10-09-S-058, 8 (Feb. 2012).

operational efficiency as a clear secondary goal. In addition, a majority of those countries surveyed stated that their number one priority is increasing the range, quality, and take-up of their Internet-based services.[23] As compared to the last survey in 2004, the report found considerable progress in the provision of basic electronic tax transaction capabilities and access to personal taxpayer information.[24]

Further, a 2012 OECD report provided the following recommendations on structuring smarter tax administrations:[25]

> Revenue bodies should continue to explore opportunities for working smarter by: 1) More rigorously applying modern compliance risk management principles and strategies; 2) Shifting compliance activities upstream and addressing compliance risks earlier in the sequence of events potentially leading to compliance failures; and 3) Facilitating compliance through electronic services with continuous improvement of these services, and by increasing their take-up.
>
> The area with most hope invested in technologies is the provision of electronic services to facilitate compliance and reduce costs and burdens. The potential is by no means exhausted.

Accordingly, the development of online services to meet the preferences of taxpayers is given high priority by revenue bodies around the world. The IRS is working toward the same goal as many other countries and could learn from their experiences in developing online products.

Online Account Access and Management Would Reduce Taxpayer Burden.

In her 2009 Annual Report to Congress, the National Taxpayer Advocate urged the IRS to provide taxpayers with electronic access to their accounts, as recommended by the 2006 TAB Phase 2 Report.[26] Such access would allow taxpayers to monitor their accounts and potentially take the initiative to correct any perceived problems without the need for prompting by the IRS. In the past, the IRS attempted to develop an online customer account program called Internet Customer Account Services (ICAS), also known as My IRS Account Application (MIRSA). However, the IRS put the project on hold in 2009 for

23 Centre for Tax Policy and Administration of the Organisation for Economic Co-Operation and Development (OECD): Forum on Tax Administration: Taxpayer Services Sub-Group, Survey Report: Survey of Trends and Developments in the Use of Electronic Services for Taxpayer Service Delivery 77 (Mar. 2010), *available at* http://www.oecd.org/ctp/taxadm/45035933.pdf (last visited Aug. 6, 2012).

24 *Id.*

25 OECD, Forum on Tax Administration, *Information Note: Working Smarter in Structuring the Administration, in Compliance, and Through Legislation* 27, 51 (Jan. 2012) (emphasis added).

26 IRS Publication 4579, 2007 Taxpayer Assistance Blueprint Phase 2, Executive Summary 2-4 (Apr. 2007), *available at* http://www.irs.gov/pub/irs-pdf/p4579.pdf (last visited Aug. 6, 2012).

several reasons, including the need to first focus on portal and e-authentication strategies and the IRS's perception of low take-up rates for a similar program in Canada.[27]

Despite the IRS's reasons for discontinuing MIRSA, the National Taxpayer Advocate recommended that the IRS continue to develop an online account program. If even a small percentage of taxpayers could detect and address account problems early in the process, they and the IRS would avoid more costly consequences. With a user-friendly interface, account access would also "demystify" the tax system for some taxpayers, leading more of them to take more ownership in the system when they see firsthand the results of their interactions with the agency. In addition, a taxpayer who receives a notice from the IRS could potentially fix the problem without hiring a paid practitioner.

The IRS response to the 2009 recommendation stated: "We believe that an online account capability may ultimately be part of a suite of services provided to taxpayers." However, the IRS then raised low take-up rates in similar applications developed by other countries and stated that e-authentication remained a barrier to development.[28]

The National Taxpayer Advocate understands that the design and implementation of an online account access and management system is a complex undertaking. However, several countries have successfully developed different variations of these applications, which the IRS should further evaluate, then build on their lessons learned.[29] In addition, the TAB Conjoint Update clearly shows that taxpayers prefer to interact with the IRS online to check the status of transactions and find out more about IRS letters and notices.[30] Further, based on the plans provided by the Office of Online Services, the IRS is working toward a goal of electronic interaction with taxpayers, by developing a way for the parties to communicate and exchange documents electronically.[31] We believe such a capability will reduce taxpayer burden and can serve as the first step toward online account management.

CONCLUSION

Both the IRS and taxpayers will benefit from the expansion of online self-service. Studies have shown that taxpayers are demanding online service channels at an increasing rate, while the OECD and its member countries have realized the benefits of prioritizing online service delivery. The IRS is moving forward with a strategy to improve IRS.gov as well

27 TIGTA, Ref. No. 2009-20-102, *Changing Strategies Led to the Termination of the My IRS Account Project* (Aug. 12, 2009); IRS, *IMRS Q&A View* (Intranet site on file with the IRS).

28 National Taxpayer Advocate 2009 Annual Report to Congress 104-105.

29 For detailed descriptions of the online account applications offered by various OECD countries, see Centre for Tax Policy and Administration of the OECD: Forum on Tax Administration: Taxpayer Services Sub-Group, Survey Report: Survey of Trends and Developments in the Use of Electronic Services for Taxpayer Service Delivery 40, 109-110 (Mar. 2010), *available at* http://www.oecd.org/ctp/taxadministration/45035933.pdf (last visited Aug. 6, 2012).

30 Wage and Investment Research & Analysis, TAB Conjoint Update: Final Report for Wage and Investment Research and Analysis Director, Project No. 2-10-09-S-058, 8 (Feb. 2012). Specifically, 38 percent preferred to get information about a notice received through an interactive website and 41 percent preferred such a tool to check the status of a transaction.

31 IRS Online Services, Governance Kickoff 3 (Nov. 29, 2011).

as provide more self-assist applications. We applaud the IRS's progress but realize that it has a long way to go to reach the state envisioned by the TAB Phase 2: an "interactive and fully integrated, online tax administration agency" with the capability "for any exchange or transaction that currently occurs face-to-face, over the phone, or in writing to be completed electronically."[32]

IRS COMMENTS

The IRS appreciates the report's recognition of our progress in the area of online services. We have made a number of significant improvements in this area and are working to make additional enhancements for the future.

In August 2012, the IRS took an important foundational step toward its future vision of improving web-based taxpayer service through the re-launch of IRS.gov with improved functionality. We migrated existing content and applications on the site to a more current operating platform that includes a content management system and portal display products. These critical tools give the IRS increased flexibility and control in the continuous updating of the site as well as the look and feel.

IRS.gov was redesigned so that navigation is mapped according to frequently used taxpayer activities (*i.e.,* filing returns, paying taxes, checking refund status). These changes have made taxpayer experience more efficient and more meaningful. The IRS continuously monitors new data analysis and reporting tools to identify areas for modification and improvement. In a similar way, the home page and banner were updated to promote organizational goals such as improving e-Filing and PTIN application renewal. We are proud to report that IRS.gov received over 372 million visits, resulting in over 1.7 billion page views, in fiscal year 2012.

Also in 2012, the IRS developed and implemented a number of meaningful enhancements and applications which improved taxpayer service on IRS.gov, including the following:

1. Our "VITA Site Locator" to help eligible taxpayers to locate free tax preparation help. It was launched in the Amazon Cloud in close collaboration with the Department of Treasury;
2. An app that allows taxpayers to conduct an immediate search for currently valid tax-exempt organizations;
3. An app that allows taxpayers to get account information on the First-Time Homebuyer Credit;

[32] IRS Publication 4579, 2007 Taxpayer Assistance Blueprint Phase 2, Executive Summary 23-4, 40 (Apr. 2007), *available at* http://www.irs.gov/pub/irs-pdf/p4579.pdf (last visited Aug. 6, 2012); Conjoint Update: *Final Report for Wage and Investment Research and Analysis Director*, Project No. 2-10-09-S-058, 5 (Feb. 2012). However, the National Taxpayer Advocate continues to believe that certain taxpayers will require face-to-face or telephone services and the IRS should not abandon these service delivery channels to meet their needs. Rather, certain categories of transactions may be better served through multiple service channels.

4. The launch of IRS2Go v2. In addition to its original features, which allow taxpayers to check refund status, follow IRS on Twitter, get contact information, and subscribe to filing season updates, the new version includes enhanced applications, such as:
    a. "Watch Us" to allow taxpayers to view IRS YouTube videos;
    b. "Get the Latest News" to allow IRS to push press releases as they go live on IRS.gov; and
    c. "Get My Tax Record" to allow users to order their tax account or tax return transcript using a mobile device.
5. Additional enhancements and tools were added to support taxpayers in the following areas:
    - The Query Tool for Forms and Publications (to improve retrieval);
    - An online calculator for the Sales Tax Deduction;
    - An AMT Assistant;
    - An EITC Assistant;
    - Link and Learn (to improve Spanish content);
    - Understanding Taxes; and
    - A Withholding Calculator.

Striving to meet taxpayers' increasing demand for online services is of vital importance for the IRS and fundamental to providing taxpayers with top quality service. For this reason, the IRS continues to look for new ways and enhanced applications to support this important endeavor. The IRS's Office of Online Services (OLS) is leading the way for the IRS's transition to the future digital government. OLS is working to ascertain what taxpayers need to effectively and simply meet their tax responsibilities whenever and wherever needed. OLS aims to deliver new high-impact functionality to improve taxpayer experience across various channels and to deliver robust cross-channel analytics to attain continuous improvement.

The IRS continually stays aware of online service offerings of foreign and state administrations to identify those that might translate well and quickly to the IRS environment. We have reviewed the online service offerings of several foreign and state tax administrations. It is important to mention that the U.S. taxpayers are afforded important protections which may not exist in other areas. As a result, the best practices of other taxing entities may not always fit the needs of IRS's customers. We do consider these sources to be informative and will consider aspects of these services along with other IRS priorities in future online strategies. The IRS, along with its business and technology partners, will continue to research, develop, and implement new self-service transactional web applications to meet the continuously evolving needs of taxpayers.

The IRS recognizes the value in the delivery of account or account-like services to taxpayers and has taken some preliminary steps in that direction. Most notably, the IRS recently developed this type of account functionality in a limited way through discrete applications on the website through *Where's My Refund* and *What Was My Stimulus Payment*. Online account capability may ultimately be part of the suite of services provided to taxpayers. Nonetheless, security and resource challenges exist in full implementation of this goal. Authentication is key to any online service strategy. As the information or services provided and the transactions involved increase in terms of sensitivity, the level of certainty about the identity of the individual who has logged on to perform the tasks grows. While the IRS has simple forms of authentication for specific functions which do not contain highly sensitive data (*Where's My Refund*), our systems currently do not support more sophisticated forms of authentication that would be required to provide taxpayers with the ability to access and resolve account issues online.

While the IRS is working on developing these more challenging forms of authentication, it is important to note that we must be mindful that these types of authentication may restrict the willingness of taxpayers to use the service. For example, several other countries have found that taxpayers are much more likely to use a service if they can log on and use it immediately by providing some basic information or shared secrets. When the authentication requirements are more burdensome and cannot be completed in the same session, the uptick in taxpayer use falls dramatically. Even when taxpayers are willing to authenticate by waiting for a confirmatory code or PIN in the mail, recent experience suggests that taxpayers often allow these codes or PINs to lapse which results in additional work for the IRS and taxpayer to revalidate.

Moreover, evidence from foreign and state governments suggests that taxpayer online accounts may not enjoy the kind of usage associated with similar applications in the private sector, such as online banking. In fact, these examples, as well as the IRS's own limited experience, suggest much larger numbers of taxpayers may be served by simple, direct "utilities" that take care of specific activities taxpayers desire. An example of this might be an application that allows taxpayers to send "certified" copies of IRS transcripts to third parties (*e.g.*, to mortgage or education lenders who need recent tax data). For these reasons, we agree that more research is needed on these issues as part of our larger assessment of e-services strategy.

These complexities underscore the need for the IRS to test and evaluate taxpayer reactions and make deliberate and thoughtful technology investment decisions with our finite resources. The IRS will continue to conduct data-driven analysis and build taxpayer-focused processes to develop online approaches and strategies that will serve the overall best interests of taxpayers.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate commends the IRS for its continued commitment to meeting the increasing taxpayer demand for online services. As discussed in detail in its response, the IRS has made significant progress in the development and enhancement of many online tools and applications to provide quality taxpayer service. We are particularly impressed with the researched-based strategy of the Office of Online Services to meet taxpayers' needs across a variety of service channels.

We understand the real obstacles facing the IRS in developing an online account program. Authentication for such a comprehensive service is much more difficult than that required for existing discrete online services. We also understand the burden imposed on taxpayers as they try to navigate complex authentication processes. However, we believe the IRS should continue to develop this program once it has overcome some of the authentication challenges through improvements in technology. Taxpayers will benefit substantially from being able to electronically monitor the status of their accounts and interact with the IRS to resolve their tax issues. While the stricter authentication may be annoying to taxpayers, it can also be reassuring. Over time, taxpayers will learn that gaining access to one's account online can be much better than sitting on the phone for 15 minutes only to get transferred to the wrong person.

Authenticated access to online accounts is only one step in the road to a comprehensive online presence. Once the taxpayer gains access to the actual site, his or her experience must be worthwhile. That is, the IRS must provide meaningful and useful content. To do this, the IRS needs to develop the in-house capability to present content.

Finally, the National Taxpayer Advocate is pleased that the IRS stays informed of the online services offered by domestic and foreign jurisdictions. We understand that the IRS must comply with strict requirements, especially with respect to privacy and security, which make it difficult to model our applications after those offered by other agencies. However, IRS technology continues to advance in this area and the IRS has committed in its response to work with industry partners to research and develop new applications to meet the continually evolving needs of taxpayers. Accordingly, we believe the IRS can strive to provide top-quality online service offerings as it learns from the experiences of other jurisdictions.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Develop an online account program to allow taxpayers to view the status of their accounts as well as interact with the IRS by responding to notices, scanning documents, etc.
2. Review online service offerings of foreign and state tax administrations to identify those that might translate well and quickly to the IRS environment.

MSP #15

Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs

RESPONSIBLE OFFICIALS

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Peggy Bogadi, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

In recent years, the IRS has devoted substantial resources to improving international tax administration and responding to the challenges of globalization.[1] However, the IRS continues to focus on stepped-up enforcement without adequate servicewide coordination, and with no corresponding increase in service to millions of individual international taxpayers.[2] The National Taxpayer Advocate's 2011 Annual Report to Congress identified six serious problems facing these taxpayers in understanding and meeting their federal tax obligations.[3]

A 2012 IRS research study of international taxpayers shows that this group remains underserved, desires self-service options, and may experience a higher rate of post-filing problems than the general taxpayer population.[4] Among those who file, many do not have an adjusted gross income (AGI) high enough to generate a tax liability. About 82 percent of U.S. taxpayers abroad did not have a U.S. liability.[5] Others are afraid to file, being uncertain about filing requirements or intimidated by the complexity of U.S. tax laws. Confusion and frustration about U.S. tax requirements, the risk of heavy penalties, and the corresponding compliance burden may cause some taxpayers to give up their U.S. citizenship. Expatriations increased more than sixfold between calendar years (CYs) 2008 and 2012.[6]

While international taxpayers grapple with compliance challenges and inadequate service, the IRS has been slow in taking specific steps to meet their needs and ease their compliance burdens, saving enforcement resources to address egregious noncompliance. We

1 *See, e.g.*, IRS, *The Budget in Brief*, FY 2011; IRS, *The Budget in Brief*, FY 2010; Pub. L. No. 111-117 (Dec. 16, 2009); Pub. L. No. 112-10 (Apr. 15, 2011).

2 *See* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 30, fn. 183 and 184. International taxpayers are broadly defined to include U.S. individuals working, living, or doing business abroad, U.S. entities doing business abroad, foreign individuals working or doing business in the U.S., and foreign entities doing business in the U.S.

3 *See* National Taxpayer Advocate 2011 Annual Report to Congress 129-272.

4 IRS, Wage and Investment Division (W&I) Research & Analysis, Research Study Report, *2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* (Aug, 2012) (2012 WIRA Research Study). Compared to all tax returns, international individual returns have almost twice the math error rate and are less likely to be filed electronically. *Id*. at 9.

5 2012 WIRA Research Study 23-24. *See also* National Taxpayer Advocate 2011 Annual Report to Congress 155-156.

6 IRS, *Quarterly Publications of Individuals Who Have Chosen to Expatriate, as Required by Section 6039G*, 2008-2011. These publications contain the name of each individual losing U.S. citizenship (within the meaning of IRC §§ 877(a) or 877A). For purposes of these listings, long-term residents, as defined in § 877(e)(2), are treated as if they were U.S. citizens who lost citizenship. The publications do not distinguish between former U.S. citizens and long-term residents.

have identified the following problems with the IRS's approach to improving international taxpayer service:

- Delays in developing specific recommendations to improve service based on cross-functional team findings;
- The lack of a strategic plan to address persistent compliance challenges;
- The absence of a timeline to implement recommendations of the 2012 IRS research study;
- The insufficient use of modern technology as a more efficient method of delivering services and providing information, including virtual face-to-face (VFTF) assistance and online services; and
- The lack of simplified filing and self-correction options for international taxpayers.

ANALYSIS OF PROBLEM

Background

In recent years, globalization has pushed an increasing number of individual taxpayers (including entrepreneurs and small businesses) to seek economic opportunities abroad. It also has increased competition among tax administration agencies for tax bases and sources of revenue. Both taxpayers and the government can benefit from tax systems that are simple to administer and have high rates of compliance.[7] For this reason, 33 countries lowered the tax burden and made compliance easier by introducing or enhancing electronic systems and reducing the frequency of filing or merging or eliminating duplicative reporting.[8] In contrast, World Bank studies consistently rank the United States between 65th and 69th in time spent to comply among 183 countries surveyed.[9]

The complexity of international tax law, combined with the administrative burden placed on international taxpayers, creates an environment where taxpayers who are trying their best to comply simply cannot. For some U.S taxpayers abroad, the requirements are so confusing and the compliance burden so great that they give up their U.S. citizenship.[10] Overall, nearly 7,000 U.S. citizens renounced citizenship from calendar year (CY) 2005 through third quarter of CY 2012.[11] The number of expatriations increased over sixfold from 231 in CY 2008 to about 1,800 in CY 2011, as shown on Figure 1.15.1

7 The World Bank, The International Finance Corporation (IFC), and PricewaterhouseCoopers (PwC), *Paying Taxes 2012*, *The Global Picture* 15 (2011). This is the seventh year that the Paying Taxes indicators have been included in *Doing Business* project run by the World Bank Group.

8 World Bank, IFC, and PwC, *Paying Taxes 2012*, *The Global Picture* 15-18 (2012).

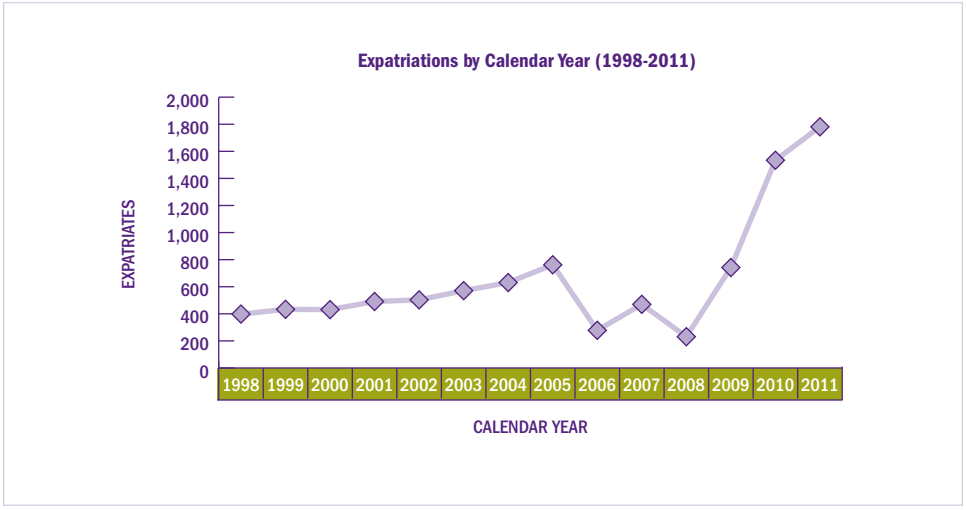
9 *See* The World Bank, IFC, and PwC, *Paying Taxes*, *The Global Picture* (2009-2012).

10 National Taxpayer Advocate meeting with the U.S. Ambassador to Switzerland (Feb. 4, 2011). *See also* Brian Knowlton, *More American Expatriates Give Up Citizenship*, N.Y. Times, Apr. 25, 2010; Helena Bachmann, *Why More U.S. Expatriates Are Turning In Their Passports*, Time World, Apr. 20, 2010.

11 IRS, *Quarterly Publications of Individuals Who Have Chosen to Expatriate, as Required by Section 6039G*, CYs 2005 – 2012 (through third quarter of CY 2012). These publications contain the name of each individual losing U.S, citizenship (within the meaning of IRC §§ 877(a) or 877A). For purposes of these listings, long-term residents, as defined in § 877(e)(2), are treated as if they were U.S. citizens who lost citizenship. The publications do not distinguish between former U.S. citizens and long-term residents.

below. Expatriations dramatically increased after CY 2009, coinciding with increased IRS enforcement of the Foreign Bank Account Report (FBAR) penalty and confusing offshore voluntary disclosure initiatives that appeared overly harsh to taxpayers who inadvertently violated the rules.[12]

FIGURE 1.15.1, Expatriations in CYs 1998-2011



Profile of International Taxpayers

In response to concerns the National Taxpayer Advocate expressed in prior Annual Reports to Congress, and in support of the IRS Multiyear Servicewide Approach to International Tax Administration, Wage and Investment Research & Analysis (WIRA) in 2012 completed a comprehensive study (hereinafter "WIRA Research Study") of the service needs and filing issues of international individual taxpayers.[13] The study found that in comparison to the general filing population, international taxpayers (defined for the purposes of the study as individuals living outside the U.S.) reported lower income, fewer refund returns, and a larger number of zero balance due returns.[14] Wage earners, however, reported significantly

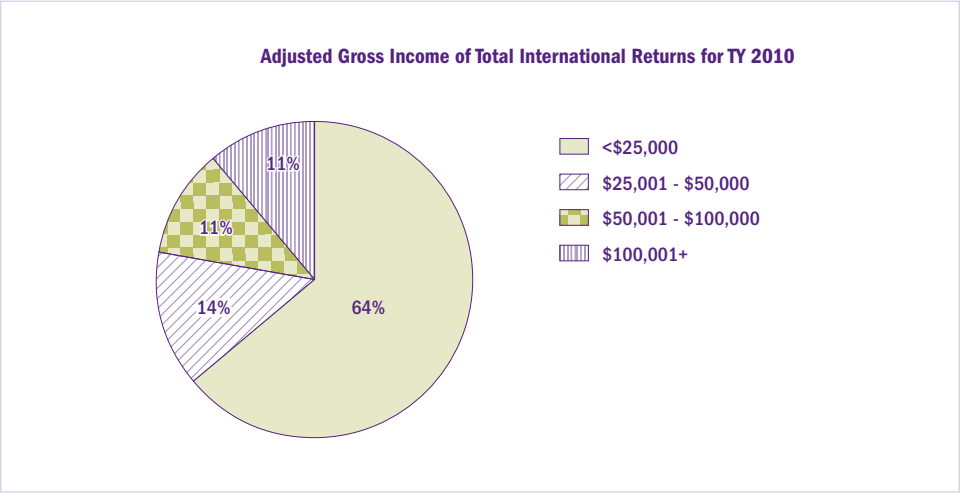
12 See Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts, infra/supra*. *See also* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 21-31; National Taxpayer Advocate 2011 Annual Report to Congress 171-272.

13 2012 WIRA Research Study 7. The research study included focus groups with tax practitioners who serve international taxpayers, demographic and tax filing profiles of international taxpayers over various tax years, multiple interviews with tax attachés working with taxpayers overseas, interviews with multinational companies based in the U.S. employing U.S. citizens overseas, the 2009 IRS Survey of International Taxpayers, collaboration with custodians of Department of State Passport Data and Certificate of Loss Nationality Data, analysis of the IRS Printing and Postage Budget Reduction (PPBR) project on direct mailings to embassies and taxpayers living abroad, and the 2011 IRS Survey of Individuals Living Abroad.

14 For the purposes of the 2012 study, WIRA defined "international taxpayers" as individuals living outside the United States, and include filers of Puerto Rican and non-resident alien returns. *Id*.

higher levels of income than all international filers.[15] The study indicates that approximately 64 percent of all international taxpayers reported an adjusted gross income (AGI) of $25,000 or less with a median AGI of $11,770, as shown on Figure 1.15.2 below.[16]

FIGURE 1.15.2, Adjusted Gross Income of Total International Returns for Tax Year 2010[17]



Nearly 58 percent of wage earners who claimed foreign earned income exclusion reported foreign wages in excess of $50,000, with a median wage of $65,400. The maximum foreign income exclusion for TY 2010 was $91,500, and the reported median for this exclusion was $63,887.[18] Only 58 percent of all international tax returns resulted in refunds, compared to 80 percent of all individual returns, while 24 percent were filed with a zero balance due, compared to just four percent of all individual returns. This difference in the percentage of zero balance returns indicates that the AGI reported by international taxpayers is often not high enough to generate a tax liability.[19]

The Creation of a Cross-Functional International Individual Taxpayer Assistance Team May Help to Better Coordinate International Taxpayer Service.

In June 2012, the IRS's Large Business & International Division (LB&I), Wage & Investment Division (W&I), and TAS created the International Individual Taxpayer Assistance Team (IITA) to develop international taxpayer service initiatives based on the National Taxpayer

15 2012 WIRA Research Study 23. International filers include three groups: U.S. civilian taxpayers abroad, military personnel stationed abroad, and non-resident Aliens. U.S. taxpayers abroad were identified by the Universal Location Code (ULC) of 98 and a null value in the STATE variable. Military filers were identified by their tax return having an Army Post Office/Fleet Post Office (APO/FPO) address. Non-resident aliens were identified by the document code (DOC_CD) of 72 or 73. *Id*. at Appendix O.

16 The median AGI calculated for total international returns excludes returns filed on Form 1040PR or 1040SS, since neither of these forms has a line item for AGI. International wages can be reduced by claiming the foreign earned income exclusion on Form 2555, *Foreign Earned Income Exclusion*.

17 2012 WIRA Research Study 22.

18 Of international taxpayers who reported foreign income, the median wage reported on line 7 of Form 1040 was $80,688.

19 2012 WIRA Research Study 31-32.

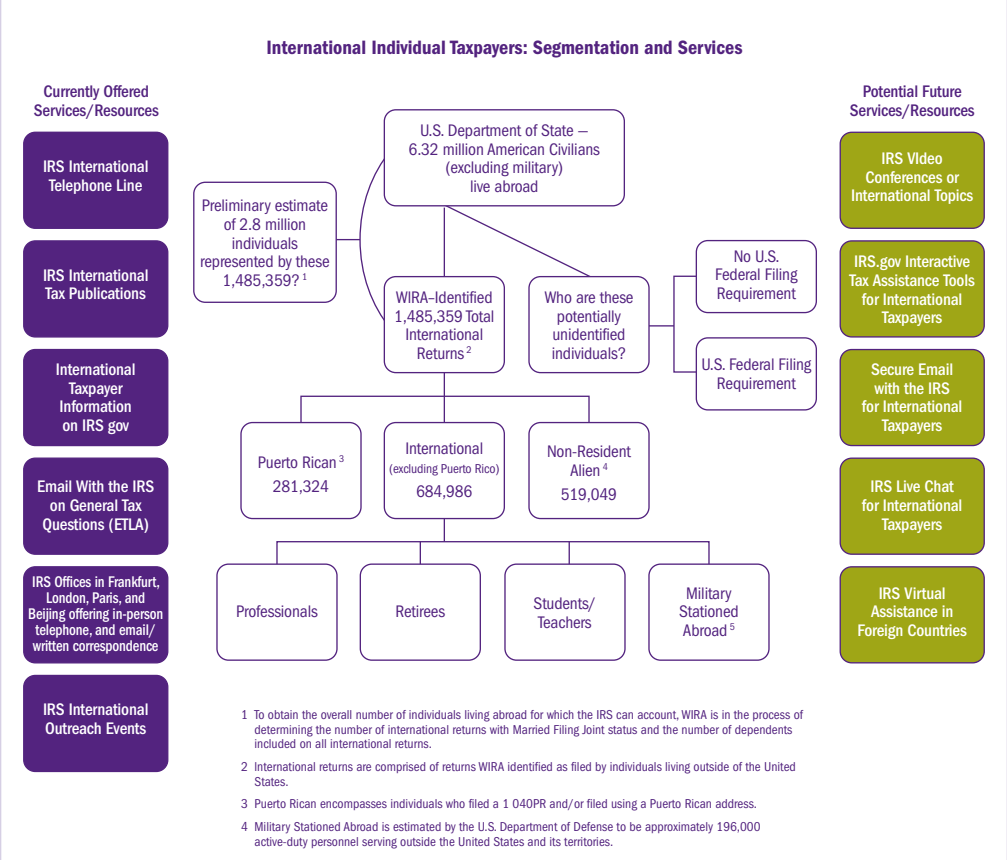
Advocate's recommendations and the 2012 WIRA study.[20] The IRS Office of Online Services joined the group in August 2012. IITA has the following objectives:

- Identify international taxpayer groups with similar characteristics;
- Identify needs of these groups;
- Identify existing channels for assistance for these groups;
- Identify service gaps for these groups;
- Identify risk factors for service gaps;
- Prioritize taxpayer groups and service gaps based upon risk factors;
- Develop solutions and sort them in a priority order based on importance and resources; and
- Involve LB&I and IRS Office of Chief Counsel experts on tax treaties and international law issues.

The WIRA representative on the IITA team facilitated discussions with other team members to identify groups of international taxpayers, current services and resources, and potential future services and resources, and developed a flow chart, reproduced as Figure 1.15.3 below.

20 *See* 2012 WIRA Research Study; WIRA, *Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors, Research Study Report* (Feb. 2010); W&I, *International Taxpayer Topline Report* 5, Pacific Consulting Group (Dec. 2009); WIRA, Research & Analysis, Focus Group Testing Report: *Customer Service Needs of U.S. Taxpayers Living Abroad, Project # 3-08-07-S-017T* (Dec. 2008).

FIGURE 1.15.3, International Individual Taxpayers: Segmentation and Services



The National Taxpayer Advocate commends the IRS for this effort and recommends making the IITA team permanent, with a formal charter and a responsibility to provide periodic written reports to Business Operating Division (BOD) executives through the existing Services Committee.[21] We encourage the team to formulate recommendations based on its findings and the WIRA study, and move forward to present them to the Services Committee.

Even though the creation of the team is a positive step, the team is moving slowly toward developing specific recommendations and a plan for their implementation. In the meantime, international taxpayers are still experiencing compliance challenges and difficulties with accessing IRS services. From the taxpayer's perspective, any improvement in service

21 The Services Committee serves as the governing body for major service investment and management decisions at the IRS. It discusses and makes decisions or recommendations on items related to taxpayer service investments, resource allocations, and program and process management in the context of IRS-wide strategic planning and budgeting (e.g. Modernization Vision and Strategy, the IRS budget, relevant research conducted by the Office of Research, Analysis, and Statistics and the Operating Divisions, etc.). IRM 22.24.1.4 (June 18, 2012).

has been minimal. TAS urges the team to move quickly in tailoring its existing services and recommending future services to meet the needs of these taxpayers.

The 2012 IRS Study Confirmed That Challenges Persist for International Taxpayers.

The 2012 WIRA research study confirmed that international taxpayers still face many compliance challenges. Most often, international taxpayers cited concern about the complexity of and confusion over international tax law, dissatisfaction with not receiving filing materials, excessive use of jargon or unclear language in IRS letters, publications, and forms, and difficulty finding information on IRS.gov.[22] Other problems described in the study include:

- *The inability to file electronic returns and to use Free File Fillable Forms (FFFF) for electronic filing.*[23] The IRS does not allow electronic filing of the 1040NR series of returns for nonresident alien taxpayers. Nor can U.S. taxpayers abroad use FFFF for electronic filing.
- *Difficulties in getting personal service.* Face-to-face assistance for international taxpayers is almost nonexistent, as they can only use four tax attaché offices in Beijing, Frankfurt, Paris, and London which receive high volumes of requests for help each month.[24]
- *Difficulties in obtaining tax information.* Taxpayers abroad can only research a limited number of FAQs and pages on IRS.gov. In addition, the Interactive Tax Assistance (ITA) tool does not deal with international topics at all. The four tax attachés hold outreach events that cover important topics for international taxpayers, such as filing obligations, Individual Taxpayer Identification Number (ITIN) applications, the foreign earned income exclusion, FBAR obligations,[25] and avoidance of double-taxation.[26] These events are usually filled to capacity.[27]
- *Difficulties obtaining tax forms and publications.* W&I's decision to stop mailing tax forms and instructions to individuals worldwide created an unprecedented number of walk-ins, calls, and emails at tax attaché posts requesting forms, instructions, and publications.[28] The resulting burden was especially hard for elderly taxpayers with dial-up or no access to the Internet and those with slow connection speed.[29] Many could not download large documents and remained uninformed about new laws and reporting

22 2012 WIRA Research Study 48.

23 Only 30 percent of international returns were filed electronically, compared to 81 percent of domestic returns. *Id*. at 21.

24 For example, during the first half of FY 2012, the London post had answered 1,730 phone calls, provided services to 1,939 walk-in taxpayers, and responded to 1,349 letters/faxes. *Id*. at 28.

25 Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*.

26 For a detailed discussion of ITIN issues, see Most Serious Problem: *The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Defer Fraud, infra/supra*.

27 2012 WIRA Research Study 29.

28 In FY 2011, under the Printing and Postage Budget Reduction (PPBR) plan the IRS eliminated the direct shipments of Package 7 (containing Forms 1040, 1040-V, 1116, 2106, 2555, 2555EZ, 3903, 6251, TD F 90-22, Schedules A, B, C, D, E, L, M, and SE, and Publication 54) to international taxpayers. Nor does the IRS ship this package to U.S. embassies in foreign countries.

29 2012 WIRA Research Study 33 (Interviews with Tax Attachés in International IRS Posts).

requirements for taxpayers with foreign financial assets because they relied on the IRS to mail them the forms and publications they needed.[30]

Technology Can Provide Cost- Effective Solutions to Many International Compliance Challenges.

Modern technology can be a more efficient method of delivering services and providing information to taxpayers.[31] The 2011 IRS Survey of Individuals Living Abroad shows that roughly two-thirds of international taxpayers prefer self-service channels and online services.[32] Based on survey responses, WIRA recommends:[33]

- *Improvements to IRS.gov* in terms of searchability, organization, and content of international tax topics;
- *Improvements to other online resources* by adding international topics to the ITA application, creating online chat, expanding email options, and revising the Free File Fillable Form program to accept foreign addresses;[34]
- *Virtual assistance for taxpayers in foreign countries* through videoconference technology, beginning with Canada and Mexico;[35] and
- *Virtual outreach to taxpayers abroad* by IRS employees in the United States.[36]

While the National Taxpayer Advocate strongly supports these recommendations, the IRS still needs to develop a systematic, structured plan for providing these and other virtual services and informing the public about their availability. In addition, the IRS should not limit improvements to online services but should also reestablish services that other international taxpayers need, such as mailing forms and publications and holding in-person outreach events.

30 The Foreign Account Tax Compliance Act (FATCA) enacted in 2010 requires that Form 8938 be filed by taxpayers who meet certain criteria regarding foreign assets beginning in January 2012. *See also* Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts, infra/supra*.

31 Organization for Economic Cooperation and Development, Forum on Tax Administration, Working Smarter in Revenue Administration-Using Demand Management Strategies to Meet Service Delivery Goals 5 (Jan. 2012).

32 WIRA Research Study 40-41.

33 Based on the survey results, the WIRA study recommended the IRS consider these areas, but specified that the IRS should first consider the feasibility of the actions in the second, third and fourth bullets.

34 Survey data and interviews with tax attachés revealed that the most frequent questions by international taxpayers deal with the Individual Taxpayer Identification Number (ITIN) application process and requests for forms and publications. Other common topics are tax law questions; filing obligations; non-filer questions; accounts and notices; Form 8938, *Statement of Specified Foreign Financial Assets; FBAR, Report of Foreign Bank and Financial Accounts*; foreign earned income exclusion, tax treaties, and tax preparation.

35 Virtual face-to-face service delivery enables taxpayers to interact directly with IRS employees using videoconferencing equipment. This recommendation adopts the recommendation of the National Taxpayer Advocate to expand the VFTF pilot program to international taxpayers. For a detailed discussion of virtual service, see Status Update: *The IRS Has Made Significant Progress in Delivering Virtual Face-To-Face Service and Should Expand its Initiatives to Meet Taxpayer Needs and Improve Compliance, infra*.

36 The IRS video portal (www.irsvideos.gov) does not contain international tax topics for individual taxpayers. TAS suggests that the IRS add information on these issues.

The IRS Could Significantly Improve Future Compliance by Simplifying Reporting Requirements, Sending Targeted Soft Notices, and Expanding Self-Correction Options.

Many international taxpayers remain confused about the requirements for return filing and reporting foreign financial accounts and assets, or are intimidated at the prospect of having to come into or return to compliance.[37] Many appear to believe the IRS will always seek to apply the maximum penalties, regardless of the situation, even to "benign actors" who inadvertently violate the rules.[38] Absent clear procedures that provide an incentive for non-filers to come into compliance without being subject to maximum penalties, the IRS is squandering an opportunity to substantially improve voluntary compliance by millions of low-profile U.S. taxpayers abroad. While an estimated 6.32 million U.S. citizens reside abroad, the IRS received only about 700,000 returns from these individuals in TY 2010.[39] Despite publicizing the reporting requirements for foreign financial accounts for years since 2007, the IRS received only 741,249 FBARs in 2011.[40]

The IRS does not have sufficient resources to identify or take enforcement actions against all non-filers. Moreover, this type of action may lack economic sense given that the AGI reported by international taxpayers is often not high enough to generate a tax liability. According to the 2012 WIRA research study (and similar TAS findings in the 2011 Annual Report to Congress), more than 80 percent of U.S. taxpayers abroad had no U.S. tax liability.[41] For taxpayers subject to foreign tax at rates higher than the U.S. effective tax rate and thereby having no liability, the IRS could develop simplified tax and information reporting options modeled after the new online FBAR form.[42]

The IRS also plans to sample filing compliance of U.S. citizens abroad through direct compliance contacts and to begin sending soft notices to non-filers based on passport data from the Department of State.[43] All U.S. passport applicants must provide a taxpayer identifying number (TIN) and identify any foreign country in which they reside.[44] The State

37 By not filing tax returns, many of these taxpayers may be forfeiting significant tax benefits, such as foreign earned income and foreign housing exclusion or deduction. However, these provisions are not automatic, *i.e.*, a taxpayer must file an election. *See also* Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, and Form 8938, *Statement of Specified Foreign Financial Assets* (commonly known as FATCA); Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (commonly known as FBAR).

38 National Taxpayer Advocate 2011 Annual Report to Congress 133-134; 191-205. *See also* Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts, infra/supra*. Most international penalties are related to information returns and are civil penalties that are not based on the amount of underpayment, *e.g.*, for failure to file information returns under 31 U.S.C. § 5321(a)(5) and IRC §§ 6038, 6038A, 6038B, 6038C, 6039F, 6046, 6046A, 6048. *See also* IRC §§ 6038D, 6662(b)(7); 31 U.S.C. § 5321(b)(1). These penalties may range from $10,000 per violation to the greater of $600,000 or 300 percent of the foreign account balance for willful failures continuing over a six-year period.

39 2012 WIRA Research Study 13, 24.

40 IRS response to TAS information request (July 27, 2012).

41 2012 WIRA Research Study 23-34.

42 *See* Financial Crimes Enforcement Network (FinCEN), BSA E-Filing System, *File an FBAR, available at* http://bsaefiling.fincen.treas.gov/Enroll_Individual.html (last visited Dec. 21, 2012).

43 LB&I request to change the corrective action due date (Sept. 24, 2012), TAS SharePoint (tracking annual report to Congress recommendations), 2009 Rec 7-1.

44 *See* generally IRC § 6039E(b).

Department shares this information with the IRS, which can match it with its own records to verify filing compliance. Because all U.S. citizens abroad are required to file returns regardless of their residency status, the IRS plans to use soft notices to remind them of these obligations.

While we generally support this initiative, the IRS should vet it thoroughly with stakeholders, including TAS, before proceeding. In addition, for this initiative to succeed, it should be combined with a self-correction option. This option could be a voluntary compliance program (VCP) that combines simplified filing with relief from all penalties, at least for international taxpayers who would not have tax liability (after applying the foreign earned income exclusion and foreign tax credit).[45] This type of program can establish per-country filing thresholds based on AGI. It would allow U.S. taxpayers residing in those countries to file a simplified, combined tax and information return form online based on their income in a foreign jurisdiction, especially if the country has an effective income tax rate higher than that of the U.S.[46] For non-filers whose filing would lead to a tax liability, the IRS can use the recently-announced Streamlined Nonresident Filing Initiative,[47] and increase the threshold from the current $1,500 of tax due to $10,000.[48] This approach could create a win-win situation — substantially decreasing burden for U.S. taxpayers abroad and encouraging benign non-filers to correct inadvertent violations without draining IRS resources, while freeing up IRS enforcement resources to address bad actors with substantial tax liabilities.

CONCLUSION

In conclusion, the National Taxpayer Advocate preliminarily recommends that the IRS:

1. Make the IITA team permanent, with a formal charter and a responsibility to provide periodic written reports and formal recommendations to the IRS Services Committee, including items for the IRS Strategic Plan and Servicewide Approach to International Tax Administration.
2. Develop a systematic and structured plan for implementing the 2012 WIRA Research Study recommendations and inform the public about the timeline.

45 According to the 2012 WIRA research study (and similar TAS findings in the 2011 Annual Report to Congress), more than 80 percent of U.S. taxpayers abroad claiming the foreign earned income exclusion (FEIE) and foreign tax credit did not have U.S. tax liability.

46 The IRS has broad authority to prescribe the time and manner in which taxpayers file returns and the format of various required forms. *See generally* IRC §§ 6001, 6011. *See also* free and easy electronic filing of the FBAR Form, Financial Crimes Enforcement Network (FinCEN), BSA E-Filing System, File an FBAR, *available at* http://bsaefiling.fincen.treas.gov/Enroll_Individual.html (last visited on Sept. 28, 2012).

47 IRS, *New Filing Compliance Procedures for Non-Resident U.S. Taxpayers* (first posted June 28, 2012), *available at* http://www.irs.gov/Individuals/International-Taxpayers/New-Filing-Compliance-Procedures-for-Non-Resident-U.S.-Taxpayers (last visited Dec. 21, 2012).

48 The National Taxpayer Advocate previously recommended increasing the $1,500 threshold to the "substantial understatement" threshold. National Taxpayer Advocate FY 2013 Objectives Report to Congress 24. Individuals who owe less than the greater of 10 percent of the tax required to be shown on the return or $ 5,000 may not have a "substantial understatement," and thus, may not be subject to an accuracy-related penalty, particularly if a negligence penalty does not apply. *See generally* IRC § 6662(d).

3. Reinstate mailing of forms and publications to international taxpayers and U.S. embassies and consulates.
4. Allow electronic filing of 1040NR series and ITIN applications for nonresident alien taxpayers, at least those not claiming a refund.
5. Develop a method of simplified tax and information reporting online, modeled after the new online FBAR form for taxpayers incurring foreign taxes higher than the U.S. effective tax rate — resulting in no tax liability.
6. Establish a voluntary compliance program for international individuals, including a combination of simplified filing and relief from all penalties for taxpayers who have no liability.
7. Increase the threshold for the Streamlined Nonresident Filing Initiative from $1,500 of tax due to $10,000.

IRS COMMENTS

The IRS recognizes the need to increase internal IRS coordination of international taxpayer service. We have made a number of improvements in this area and continue to look for opportunities to improve service delivered to this taxpayer base.

In 2010, the IRS reorganized the office of the Deputy Commissioner, International (Large Business & International) to align international technical professionals within a single office to better identify, address and resolve significant compliance issues faced by both individuals and businesses operating across borders. In 2011, LB&I further realigned to form the position of Assistant Deputy Commissioner, International, responsible for overseeing treaty assistance and interpretation, treaty negotiations, exchange of information, international programs, overseas operations, and service wide coordination. The Transfer Pricing Operations unit was also formed to manage transfer pricing compliance and promote strategic case development across the organization. This further realignment was driven by LB&I's continuous focus and recognition of the high complexity of the tax laws applicable to taxpayers engaged in international activities and the commensurate challenges to the IRS in communicating and enforcing those legal complexities. The Deputy Commissioner, International, is responsible for coordinating IRS efforts in this area across all IRS Business Operating Divisions to ensure that the IRS's international strategy is aligned, balanced, and coordinated.

Improving taxpayer service to U.S. taxpayers who work, live, and conduct business abroad is an important strategic goal for the office of the Deputy Commissioner, International, and the IRS in general. As part of FY 2013 priorities, the International Executive team is committed to coordinating closely with W&I, Online Services, the Return Preparer Office, Associate Chief Counsel International (ACCI), and Taxpayer Advocate Service to improve access to taxpayer service with respect to international tax challenges faced by individual

taxpayers. We will consider the views included in the National Taxpayer Advocate's Annual Report in this effort.

Current IRS Efforts

The IRS has taken a number of steps throughout the organization to better coordinate delivery of service to international taxpayers.

International Individual Taxpayer Assistance Team

In June 2012, a cross-functional International Individual Taxpayer Assistance Team was formed to better coordinate and develop international taxpayer service initiatives. This team consists of LB&I, W&I, ACCI, TAS, and Online Services. The IRS recognizes the need and importance of having a team focused on international taxpayers operating in a complex global tax environment. The IITA is currently in its pilot stage, and its effectiveness will need to be evaluated and measured. After the completion of this evaluation, the IRS will consider whether the IITA should become permanent with a formal charter.

W&I Study of Individuals Living Abroad

Building on the success of the first phase of international taxpayer research resulting in the 2010 *Understanding the International Taxpayer Experience Research Study Report*, Wage and Investment Research & Analysis kicked off a second phase of research to further develop and refine the IRS's understanding of international taxpayer service needs, preferences, and behaviors. The focal point of this second phase of research is the 2011 *IRS Survey of Individuals Living Abroad*, with its specific interest in international taxpayers' experiences, expectations, and preferred alternatives to an IRS international telephone line.

In an effort to reach a wider population of international taxpayers, WIRA used groundbreaking research methodology and resources, including the IRS non-filer database, U.S. Department of State Passport data, Certificate of Loss of Nationality data, and expatriate affinity groups to administer the 2011 survey to international filers and non-filers, non-resident aliens, overseas military personnel, and expatriates. A comprehensive report of the survey findings, the *2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors*, was completed and released in August 2012.

The report concluded that there is consistency with each international taxpayer in terms of confidence in the information received from the phone versus the website, their opinions of visiting IRS.gov prior to calling the IRS, and also in the opinions of the hours of operations of the telephone lines. In summary, there was consistent alignment in what the international taxpayers say they want, say they use, and actually use.

The WIRA report revealed several areas for potentially improving the taxpayer experience of individuals living abroad, including:

(1) Improvements to IRS.gov: The WIRA study identified improvements to IRS.gov as an area of consideration, with an emphasis on searchability, organization, and content. In August 2012, the IRS launched a completely redesigned IRS.gov. The redesigned site includes a new intent-driven navigation system (*e.g.,* filing, payments, refunds) to replace the old system that focused on the type of search (*e.g.,* individual, business, professional). This new platform allows the IRS to deliver more service at a faster pace. With more than two billion page views annually, this update will be a significant help to taxpayers. We recognize that further refinements may be necessary to improve the international portion of the site; hence, the IITA has established this as a priority item in enhancing international taxpayer service.

(2) Effective Utilization of Online Resources: The WIRA study suggested that the IRS consider the following items to improve the utilization of online resources by international taxpayers:

- Prioritize the rollout of international tax topics on the Interactive Tax Assistant (ITA) application on IRS.gov. The IRS will consider adding international tax topics to the ITA application by possibly implementing the utilization of decision trees to assist international taxpayers with frequently asked questions.
- Institute online chat and expand email with the IRS as alternative communication channels for individuals living abroad. The IRS continues to consider expanded online chat and email options for taxpayers. However, the protection of private taxpayer information is a major concern of the IRS, and the IRS must ensure that this concern is addressed before online chat can be introduced and email options can be expanded.
- Prioritize the funds needed to make Free File Fillable Forms an electronic tax filing option for everyone. For tax year 2012 (filing year 2013), FFFF will support the use of foreign addresses combined with the electronic filing of forms. As a result, any forms that are included as an FFFF can be e-filed, regardless of the taxpayer address.

Forms 1040NR, *U.S Nonresident Alien Income Tax Return,* and W-7, *Application for IRS Individual Taxpayer Identification Number,* have been identified as candidate forms for electronic filing. A number of factors such as budget, resource availability, and performance improvement releases must be taken into account in determining the sequence of new electronic filing. The IRS will continue to evaluate implementing these two forms into the MeF platform.

(3) Virtual Assistance for Taxpayers Abroad: The WIRA study suggested the IRS consider the feasibility of piloting virtual assistance in Canada and Mexico. The IRS piloted virtual service delivery (VSD) at 19 domestic locations for filing year 2012. The pilot program was considered successful and VSD was expanded to an additional 53 domestic locations in October 2012. The IRS will consider the feasibility and benefit of expanding this program to locations outside the United States and will welcome the input of the NTA

to determine the most beneficial locations for providing this service to our international taxpayers abroad.

(4) Coordination between W&I and LB&I for International Individual Taxpayers: The WIRA study mentioned that W&I and LB&I have a common goal of providing exceptional service to our individual taxpayers. The study suggested that W&I could consider involving LB&I employees in selected training classes intended for W&I employees at the Philadelphia International Section and the Austin ITIN Unit. LB&I has begun this collaborative effort with W&I and has participated in discussions to consider the feasibility of this suggestion.

Improved Taxpayer Service Programs for International Taxpayers

The following are current taxpayer services offered by the IRS to international taxpayers:

Streamlined Filing. The IRS in June 2012 issued IR 2012-65[49] to provide for streamlined filing of certain tax returns. These new Streamlined Procedures apply to non-resident, non-filers whose returns constitute "low risk." A return will be determined to be "low risk" if it is a simple return with tax due below $1,500. To qualify, taxpayers must file returns for their three most recent delinquent tax years. Low risk returns will not be subject to either the failure to file a return penalty under IRC § 6651(a)(1) or the failure to pay tax penalty under IRC § 6651(a)(2) or information return penalties (*e.g.,* FBAR penalties). We believe these new Streamlined Procedures accomplish the establishment of a voluntary compliance program for international individuals, including a combination of simplified filing and relief from all penalties for taxpayers who have no liability.

As the National Taxpayer Advocate points out, according to the 2010 WIRA research study, more than 80 percent of US taxpayers abroad had no US tax liability.[50] The IRS continues to monitor feedback from stakeholders, but we do not believe it would be appropriate to raise the ceiling for the streamlined program to $10,000. A number of factors, including equity and fairness issues for taxpayers living in the US, are relevant.

Publications. The IRS has created several publications to assist international taxpayers. Publication 4732, *Federal Tax Information for U.S. Taxpayers Living Abroad,* is a useful resource that is located on IRS.gov and was recently updated (November 2012). There is general information for the international taxpayer on filing requirements, filing deadlines, help with tax questions, common publications, a listing of embassies and consulates with on-site IRS assistance, and other helpful information. Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad,* Publication 519, *U.S. Tax Guide for Aliens,* Publication 901, *Tax Treaties,* and Publication 597, *Information on the United States—Canada Income*

49 IR 2012-65, June 26, 2012, IRS announces effort to help US citizens overseas including dual citizens and those with foreign retirement accounts.

50 2012 WIRA Research Study 23-24.

Tax Treaty, are available on IRS.gov and may also be available at U.S. consulates and U.S. embassies.

With respect to the recommendation to reinstate mailing forms and publications to international taxpayers and U.S. embassies and consulates, the process used for providing forms internationally is not substantially different than the process used in the United States for domestic taxpayers. The current International Program provides tax products to United States embassies, consulates, and various military legal assistance offices worldwide. Although forms are not mailed automatically, those entities can order bulk quantities of up to 81 different tax products that they need to provide the necessary level of service in those geographic areas. Each year, the various organizations are provided with a Form 14004, *International Program Order Form*, and Publication 4605, *International Program Quick Reference Guide*, which they use to order IRS tax products made available for U.S. citizens abroad to file their federal tax returns.

International taxpayers can also obtain products and information as outlined on IRS.gov at http://www.irs.gov/uac/Contact-My-Local-Office-Internationally.

In-person Taxpayer Services at Four Foreign Posts Led by Tax Attachés. Taxpayer assistance is provided in London, Paris, Frankfurt, and Beijing. In addition, outreach events are conducted by each Tax Attaché in his or her designated countries of jurisdiction to enhance taxpayer assistance and treaty partner relationships.

The duties of the Tax Attaché include the provision of taxpayer service involving U.S. citizens, non-resident aliens, and entities and the presentation of outreach events with the Department of State, practitioner communities, business organizations, and other federal, state, and local agencies.

Free Return Preparation for U.S. Military Living Overseas. To assist all military personnel living overseas, the IRS provides free tax assistance and return preparation at its Volunteer Income Tax Assistance sites. For FY 2012, IRS had 60 VITA sites located overseas at U.S. military bases where volunteers prepared approximately 40,180 returns through May 2012.

Over the Phone Interpreter (OPI) Service and Pilot. In 2009, the IRS implemented the Over the Phone Interpreter (OPI) Service at Taxpayer Assistance Centers throughout the United States. In 2011, the IRS piloted an OPI Service program for use at VITA/Tax Counseling for the Elderly (TCE) sites nationwide. This program allows IRS to serve taxpayers with limited English proficiency by providing foreign language translation services to partners and volunteers at VITA/TCE sites. This pilot expands existing OPI services previously only available for use by IRS employees. The service, offered at no cost to taxpayers or participating partners, allows our partners/volunteers to communicate with LEP taxpayers at their sites in over 170 foreign languages, thereby facilitating the return preparation process.

The FY12 OPI pilot was conducted January 17, 2012 through June 30, 2012, with 50 VITA/TCE sites participating nationwide (including Hawaii). Call volumes remained low throughout the pilot period; as a result, funding was reduced. Weekly status meetings continued with SPEC management to evaluate its usage and success. Since only 24 total responses were received, a management decision was made to discontinue the OPI pilot for the 2013 filing season.

Foreign Language Websites. In addition to recent improvements to IRS.gov, the IRS has two special websites available to taxpayers with limited English proficiency. The first, www.irs.gov/Spanish, includes access to many forms and publications in Spanish, including Publication 17, El Impuesto Federal sobre los Ingresos (Your Federal Income Tax). The second, www.irs.gov/Individuals/Multilingual-Gateway, has information in Chinese, Korean, Vietnamese, and Russian. The IRS provides a DVD on basic tax responsibilities in five languages – Spanish, Chinese, Russian, Vietnamese, and Korean. This DVD is available at no charge.

The IRS will continue efforts to expand our strategic approach to international compliance by collaborating with TAS to address specific needs and compliance challenges of international taxpayers and coordinate international taxpayer service initiatives for all IRS functions.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased with the IRS's commitment to improving taxpayer service to U.S. taxpayers who work, live, and conduct business abroad. We are also appreciative of the IRS's effort to coordinate international taxpayer service through the cross-functional International Individual Taxpayer Assistance team, in which TAS actively participates. The National Taxpayer Advocate strongly supports the team's efforts and believes that it has proven itself a vital tool in developing service channels for international taxpayers. The team's success depends on its adoption of a formal charter with clearly identified rights and responsibilities for all participants. The IRS cannot fairly evaluate the IITA's effectiveness without first identifying its mission, goals, and measures of performance in a formal charter.

The National Taxpayer Advocate commends the IRS for continued research on the filing behaviors, needs, and preferences of individual taxpayers living abroad, including the excellent 2012 WIRA research study. The study made a number of recommendations to improve service for international taxpayers, which TAS strongly supports. However, the National Taxpayer Advocate believes that the IRS cannot efficiently implement these steps without a systematic and structured plan available to the public. We look forward to working with the IRS on developing such a strategic blueprint for implementing the WIRA recommendations. We believe the IITA should develop a draft plan over the next six months and submit it to the IRS Services Committee for review and approval.

The National Taxpayer Advocate is pleased with the IRS's plans to significantly enhance IRS.gov and other online resources, including the rollout of international tax topics for the ITA application and availability of FFFF for use with foreign addresses beginning in 2013 (for TY 2012 returns). The IRS should continue to expand the availability of FFFF by making more forms and schedules fillable, particularly the new Form 8938, *Statement of Specified Foreign Financial Assets*, which if required must be filed with the tax return to comply with FATCA.[51] The National Taxpayer Advocate, however, is concerned about the lack of commitment to allow electronic filing of the 1040NR series of returns. The IRS should establish a timeline for implementation of Form(s) 1040NR and W-7 electronic filing and for resolution of security concerns for online chat and secure email.[52] The National Taxpayer Advocate also strongly supports the expansion of Virtual Assistance to taxpayers

51 IRS, *List of Available Free File Fillable Forms, available at* http://www.irs.gov/uac/List-of-Available-Free-File-Fillable-Forms (last visited Dec. 18, 2012). The available forms include Form 1116, *Foreign Tax Credit*; Forms 2555 and 2555-EZ, *Foreign Earned Income Exclusion*; Form 8891, *U.S. Information Return for Beneficiary of Certain Canadian Registered Retirement Plans*; Form 8689, *Allocation of Individual Income Tax to the U.S. Virgin Islands*; and Form 8621, *Return by a Shareholder of a Passive Foreign Investment Co. or Qualified Electing Fund*. We note that although FBARs are not filed with the tax return, a link to the FBAR form on FFFF would also be helpful.

52 However, it is unclear how the IRS is planning to accept electronically filed ITIN applications while continuing to require the concurrent filing of a paper tax return with the ITIN application. For a detailed discussion of ITIN issues, see Most Serious Problem: *The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Defer Fraud, infra/supra*.

abroad, and commits to work with the IRS to identify international sites for such service. These options are vital for alleviating compliance burdens faced by international taxpayers.

The National Taxpayer Advocate remains concerned about limited options available to "benign" U.S. taxpayers abroad who have not filed returns for various reasons and who have a *de minimus* tax liability. We believe the IRS should tailor its procedures for different groups of nonfilers and not employ a one-size-fits-all approach. Taxpayers who have not timely filed tax or information returns (*e.g.*, an FBAR) should not be herded into one "streamlined" program.[53] The National Taxpayer Advocate recommends establishing broad but clearly defined categories for different groups of international taxpayers, based on the country of residence, effective foreign tax rate, and AGI.[54] U.S. taxpayers abroad, including those who may have a liability exceeding the $1,500 threshold, and especially those who did not file, should have easy self-correction options that combine simplified filing (or self-identification) with relief from all penalties if the taxpayer remains compliant for at least five years afterward. U.S. taxpayers abroad should also be able to file a simplified, combined tax and information return form online based on their income in a foreign jurisdiction, especially if the country has an effective income tax rate higher than that of the U.S. Given the complexity of U.S. international tax rules and the incompatibility of the U.S. worldwide system of taxation with that of most foreign countries that have territorial systems and value added tax, it is also reasonable to increase the current threshold for the "streamlined' filing from $1,500 of tax due to $5,000.[55] This approach will allow many international taxpayers to come into or return to compliance without draining IRS enforcement resources.

In regards to ordering international forms and publications online, the IRS.gov page does mention the Form 14004, *International Program Order Form*, and Publication 4605, *International Program Quick Reference Guide*.[56] However, the link offers only employer publications and information return forms, and does not contain forms and publications for international taxpayers. The IRS should make forms and publications available to taxpayers with no Internet access or low connection speed as well as at U.S. embassies and consulates. U.S. taxpayers abroad with limited or no Internet access rely on the availability

53 IRS, *IRS Announces Effort to Help US Citizens Overseas Including Dual Citizens and Those With Foreign Retirement Accounts*, IR 2012-65 (June 26, 2012); *see also* IRS, *Instructions for New Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers, at* http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers (last visited on Dec. 5, 2012).

54 For a detailed discussion of a three-category approach to improving the offshore voluntary disclosure programs to encourage voluntary compliance among those who failed to file FBARs and similar information returns, *see* Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts, infra/supra*.

55 *See* National Taxpayer Advocate FY 2013 Objectives Report to Congress 12-31. *See also* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 35-73 (Research Study: *An Analysis of Tax Administration Issues Raised by a Consumption Tax, Such as a National Sales Tax or Value Added Tax*). We have modified our recommendation here regarding the increased dollar limit to be consistent with our proposed limit in Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts, infra/supra*, (recommending a cap of $5,000 tax due for the Streamlined Non-Resident Filing Initiative, consistent with thresholds for application of an accuracy-related penalty under IRC § 6662(d).)

56 IRS, *International Program Information, available at* http://www.irs.gov/uac/International-Program-Information (last visited on Dec. 5, 2012).

of IRS materials at U.S. diplomatic posts. It is also important that the website provide the necessary individual international forms and publications for online ordering from abroad.

Finally, the National Taxpayer Advocate urges the IRS to expand free preparation of returns for U.S. military personnel at 60 overseas locations to civilian U.S. citizens in those countries. It would require minimal resources but will significantly expand services for U.S. taxpayers abroad. We also encourage the IRS to expand Over the Phone Interpreter (OPI) service to overseas VITA sites and translate all of IRS.gov content into Spanish.

The National Taxpayer Advocate welcomes active collaboration between the IRS and TAS within the IITA team and elsewhere to address specific needs and compliance challenges of international taxpayers and to coordinate international taxpayer service initiatives.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Make the IITA team permanent, with a formal charter and a responsibility to provide periodic written reports and formal recommendations to the IRS Services Committee, including items for the IRS Strategic Plan and Servicewide Approach to International Tax Administration.
2. Develop a systematic and structured plan for implementing the 2012 WIRA Research Study recommendations and informing the public about the timeline.
3. Reinstate mailing of forms and publications to international taxpayers who lack Internet access, and to U.S. embassies and consulates, and allow easy online ordering of international forms and publications through IRS.gov.
4. Accelerate electronic filing of 1040NR series returns and ITIN applications for nonresident alien taxpayers, at least for those not claiming a refund; and extend free file fillable ability to Form 8938.
5. Develop a method of simplified tax and information reporting online, modeled after the new online FBAR form for taxpayers incurring foreign taxes higher than the U.S. effective tax rate — resulting in no tax liability.
6. Establish a voluntary compliance program for individual international taxpayers, including a combination of simplified filing and relief from all penalties for nonfilers and taxpayers in countries with tax at rates higher than the U.S. effective tax rate
7. Increase the threshold for the Streamlined Nonresident Filing Initiative from $1,500 of tax due to $5,000.

MSP #16

IRS Processing Flaws and Service Delays Continue to Undermine Fundamental Taxpayer Rights to Representation

RESPONSIBLE OFFICIALS

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Karen Hawkins, Director, Office of Professional Responsibility

DEFINITION OF PROBLEM

Taxpayers generally have a right to representation before the IRS when they appoint certified public accountants (CPAs), attorneys, enrolled agents (EAs), or other authorized persons to advocate on their behalf.[1] Taxpayers appoint these representatives by completing and signing Form 2848, *Power of Attorney and Declaration of Representative*, and giving it to their representatives, who will mail, fax, or submit the form electronically to an IRS function or a Centralized Authorization File (CAF) unit.[2] The CAF units record and track Form 2848 authorizations to help IRS employees identify represented taxpayers, and to provide representatives with notice of adverse IRS actions against their clients. The IRS also provides e-Services and the Practitioner Priority Service (PPS) phone line to assist authorized representatives with account-related issues. However, if the CAF units do not timely process Forms 2848, systems and employees that generate notices to taxpayers will not be able to send these notices to the right representatives or addresses. Further, IRS employees may assume the taxpayer is unrepresented and contact him or her directly, or disclose information to an unauthorized representative, both of which violate taxpayers' fundamental rights to representation and privacy. When the IRS fails to process Form 2848 properly, it effectively shuts the door to the right to representation set forth in the IRC.[3]

While Form 2848 filings increased by 89 percent between fiscal years (FY) 2004 and 2012, the number of employees dedicated to processing per 100,000 forms decreased by 34 percent.[4] The IRS may have become more efficient in processing Forms 2848 since 2010, yet the processing time allowed by the IRS per Form 2848 increased 233 percent, from three calendar days to a maximum of ten days — increasing the risk that taxpayers will not

1 Internal Revenue Code (IRC) §§ 6304(a)(2) and 7521(b)(2). Publication 1, *Your Rights as a Taxpayer* (Sept. 2012), generally provides information to taxpayers regarding the right to representation during examination, collection, or appeal of a tax liability.

2 IRS, *Instructions for Form 2848* (Mar. 2012). Form 2848, *Power of Attorney and Declaration of Representative* (Mar. 2012), also permits the representative's access to the taxpayer's account information. The Centralized Authorization File (CAF) unit also processes Form 8821, *Tax Information Authorization*, which only permits the representative's or other person's access to taxpayer's account information. This report focuses primarily on Form 2848 processing.

3 Represented taxpayers have additional rights under the Code. IRC § 6304(b)(2) provides that the IRS may not communicate with a represented taxpayer in collection matters, unless the representative fails to respond within a reasonable time, or consents to direct communication with the taxpayer. IRC § 7521(c) provides that taxpayers have the right to be represented in interviews.

4 IRS response to TAS information request (Aug.10, 2012). IRS email updating response to TAS information request (Oct. 10, 2012). IRS, Compliance Data Warehouse (CDW), Integrated Data Retrieval System (IDRS), analysis of IDRS business master file (BMF) and individual master file (IMF) transaction code (TC) 960 for FY 2004 through FY 2012.

receive the benefit of representation during critical periods.[5] Further, the IRS has discontinued its CAF unit help lines, reallocated help line staffing to processing, and directed practitioners to use the PPS line for Form 2848 authorization issues, even though PPS call assistors answered only 73 percent of their calls in FY 2012.[6]

The National Taxpayer Advocate identified IRS Form 2848 authorization policies and procedures as a most serious problem for taxpayers and made actionable recommendations to improve the program in her 2009 and 2010 Annual Reports to Congress. Concerns remain over the IRS's failure to adopt these recommendations and improve its program and services for taxpayers and their representatives Chief among these concerns:

- Practitioners lose valuable time resubmitting Forms 2848 when IRS employees use archaic systems and do not confirm manual input of the forms into the CAF;
- Taxpayers' information may be disclosed to the wrong representative, because the IRS does not verify Form 2848 authorizations on its e-Services system;
- The IRS's elimination of CAF unit help lines and additional burden on the PPS phone line could put taxpayer information in the wrong hands or deny representation when representatives are unable to submit or revoke Form 2848 authorizations;
- Low Income Taxpayer Clinics (LITCs) lack a reliable processing system in the CAF units to provide seamless representation for their clients; and
- The IRS improperly bypasses taxpayers' representatives and offers no remedies or explanations to the taxpayers.

ANALYSIS OF PROBLEM

Background

Taxpayers generally appoint CPAs, attorneys, or EAs to act on their behalf by completing and signing Form 2848 or its equivalent, and giving it to the representative, who will mail, fax, or electronically send the form directly to an IRS function or CAF unit.[7] Practitioners who hold a valid Form 2848 can represent a taxpayer by submitting correspondence or speaking directly to an IRS agent on all matters before the IRS, even if the taxpayer is not

5 National Taxpayer Advocate 2010 Annual Report to Congress 171, 179. *See* IRS response to TAS information request (Aug.10, 2012). In 2010, the average Form 2848 processing rate per hour was 12.7. The rate rose to 13.8 per hour in 2011, and through June 2012, the average processing rate was 14.8 per hour, a 16.5 percent increase from 2010.

6 IRS, Servicewide Electronic Research Program (SERP), *Alert 12A0555: Centralized Authorization File (CAF) Help-line* (Oct. 2, 2012), generally diverted help line calls to the applicable Individual or Business Accounts toll free phone line. Internal Revenue Manual (IRM) 3.42.8.8.6.1, *Rejected TDS* (Oct. 1, 2012) and IRM 3.42.8.8.4.3, *CAF Unit Faxing* (Oct. 1, 2012) provides that practitioners call the PPS line to assist with Form 2848 authorization issues. *See also* http://www.irs.gov/Tax-Professionals/Practitioner-Priority-Service-® (last visited Nov. 19, 2012), the PPS line is "practitioners' first point of contact for assistance regarding taxpayers' account-related issues." IRS, Joint Operations Center, *Snapshot Reports: PPS* (weeks ending Sept. 30, 2011 and Sept. 30, 2012). Level of Service (LOS) reflects the percentage of calls that reached telephone assisters among all calls attempted by practitioners.

7 IRS, *Instructions for Form 2848* (Mar. 2012). The IRS is also authorized to accept a power of attorney other than a Form 2848, *Power of Attorney*, provided that it includes (1) the name and address of the taxpayer; (2) taxpayer identification number of the taxpayer; (3) name and address of the recognized representative; (4) description of the matter for which representation is authorized (*i.e.*, type of tax, form number, specific years or periods involved); (5) clear expression of taxpayer's intent to be represented on the matter; (6) signature of the taxpayer and the date of signing; and (7) a signed declaration of representative. However, the power of attorney must be accompanied by a completed Form 2848 to be recorded on the CAF. Treas. Reg. § 601.503.

present. Further, authorized practitioners may use IRS e-Services and the PPS phone line to resolve their cases, in addition to all the services a taxpayer would be entitled to use. IRS e-Services provides registered practitioners Internet access to file Form 2848 authorizations, generate taxpayer transcripts, and correspond with the IRS electronically.[8] The PPS line is a nationwide toll-free telephone line dedicated to assisting authorized practitioners with their clients' account-related issues.[9] Thus, Form 2848 is the doorway to effective representation.[10]

Archaic Systems and CAF Units' Delays Harm Taxpayers.

The CAF units receive Form 2848 authorizations by correspondence or fax, and an examiner manually records the documents into an IRS database with links to the appropriate taxpayer accounts and tax modules in the Integrated Data Retrieval System (IDRS). CAF examiners input a Power of Attorney (POA) indicator on the taxpayer's master file account on IDRS, and various online tools and inventory management systems remind employees to check the master file to determine if a representative is authorized to practice before the IRS on a specific matter.[11] However, various failures often impede this process, leaving taxpayers without representation.

First, the IRS does not process Forms 2848 promptly. In 2010, the CAF units experienced significant delays in processing authorizations and extended processing timeframes from two business days for fax receipts and five business days for mailed receipts to 15 calendar days for all submissions.[12] The current processing time set by IRS procedures is ten calendar days or less, due to the CAF units' ineffective and outdated systems.[13]

Second, the multiple high-speed fax machines that the CAF units use to receive over half of their inventory do not function properly. That inventory consists of Form 2848 authorizations and disclosure consents on Form 8821, *Tax Information Authorization*.[14] The fax machines occasionally fail to transmit all pages, frequently break down, and sometimes do not receive an authorization sent by a taxpayer, which means the taxpayer loses the right to

8 IRM 3.42.8.1(1) (Oct. 1, 2012). E-Services also permit practitioners and electronic return originators (ERO) to file Forms 8821, *Tax Information Authorization*, electronically. EROs who have e-filed five or more accepted returns are also eligible to file Form 2848 authorizations, to obtain taxpayer transcripts, and to correspond with the IRS electronically. Reporting agents who e-file may gain access to e-Services to obtain taxpayer transcripts, and to correspond with the IRS electronically. *See* http://www.irs.gov/Tax-Professionals/e-services---Online-Tools-for-Tax-Professionals (last visited Oct. 2, 2012).

9 IRM 3.42.8.1(4) (Oct. 1, 2012).

10 Represented taxpayers have additional rights under the IRC. IRC § 6304(b)(2) provides that the IRS may not communicate with a represented taxpayer in collection matters, unless the representative fails to respond within a reasonable time, or the representative consents to direct communication with the taxpayer. IRC § 7521(c) provides that taxpayers have the right to be represented in interviews.

11 IRM 21.3.7.1.4 (Oct. 1, 2008). CAF examiners will record a Form 2848 into the file as long as the taxpayer's identity, the representative's identity, the type of tax return, the tax periods, the taxpayer's signature and date, and the representative's designation, jurisdiction, signature, and date are provided. IRM 21.3.7.5.2 (Aug. 25, 2009). *See, e.g.*, IRM 5.19.5.3.6(2) (Dec. 1, 2007). In the Automated Collection System (ACS), a CAF indicator displays on the employee's computer screen if there is a representative authorized to practice before the IRS.

12 The IRS maintains CAF units in its Philadelphia, Ogden, and Memphis campuses. IRM 21.3.7.1.3 (Oct. 1, 2012). IRM 21.3.7.1.7 (Oct. 1, 2008).

13 IRM 21.3.7.1.4 (Sep. 23, 2011).

14 IRS response to TAS information request (Aug.10, 2012). This report focuses primarily on Form 2848 processing.

representation until the practitioner learns the IRS has not processed the form and successfully resubmits it.[15]

Lastly, the IRS sometimes misplaces or fails to record authorizations it does receive. The IRS does not know how many Forms 2848 are not processed, because it does not record or track incomplete or misplaced receipts. Because the IRS does not acknowledge receipt of a Form 2848 authorization or advise the submitter that the Form 2848 is complete and recorded, the submitter has no way of knowing the IRS has accepted and processed the form. The IRS maintains that submitters should rely on confirmations printed by their fax machines to show successful transmission.[16] However, confirmation that a submitter faxed a Form 2848 does not prove the CAF unit processed it.[17] TAS cannot confirm how often this happens, because the IRS does not track receipts. Until representatives can confirm processing of the Form 2848 authorization, some will fax duplicate Forms 2848, meaning the CAF units may be creating their own backlogs.[18]

The IRS Has No Plans to Fully Automate Recording of Form 2848 Authorizations, Despite Seeking Solutions to Track Receipts.

The IRS has attempted to improve efficiency and accuracy within the CAF units and is exploring technology that could improve processing of faxed and mailed Forms 2848. To their credit, the CAF units have increased the number of Forms 2848 processed per hour by 16.5 percent since 2010.[19] Yet as Figure 1.16.1 below shows, Form 2848 receipts are outpacing CAF units' staffing, preventing a return to the pre-2010 processing time of two to three calendar days from the current ten days or less.

15 When receipts are dated and time-stamped by its fax machines, the IRS requires no further action as evidence of receipt. IRM 21.3.7.1.4(4) (Sep. 23, 2011).

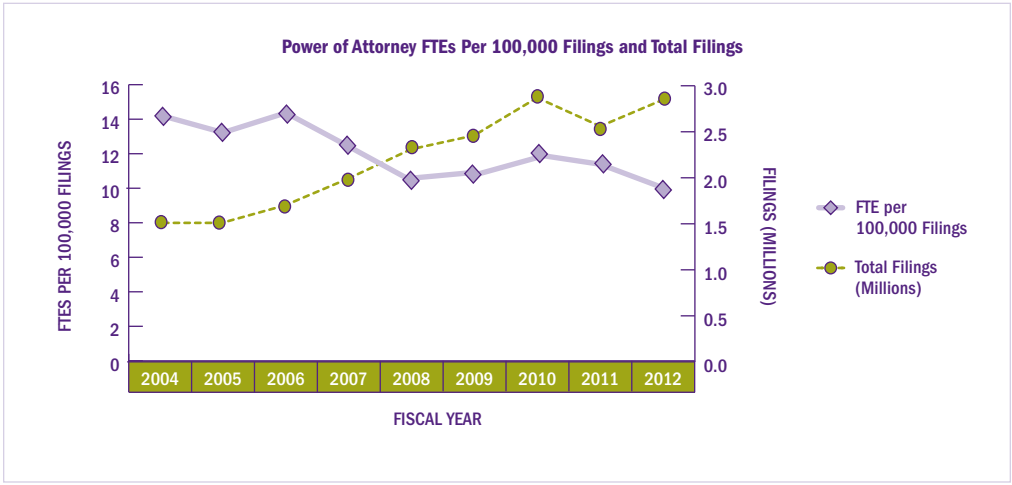
16 IRS response to TAS information request (Aug.10, 2012).

17 *See, e.g.*, IRS, Issue Management Resolution System (IMRS) Issue 11-0001415, *Multiple attorneys on one Form 2848* (Feb. 2011).

18 *See, e.g.*, IRS IMRS Issue 11-0001525, *Form 2848 processing delays* (Feb. 2012). The submitter requested that the IRS modify the IRM to reduce overall CAF processing to five days since resubmitting the Form 2848 authorization to the PPS or Automated Collection System is burdensome and costly to both practitioners and the government.

19 IRS response to TAS information request (Aug.10, 2012). In 2010, the average Form 2848 processing rate per hour was 12.7. The average rate increased to 13.8 per hour in 2011, and through June 2012, the average processing rate was 14.8 per hour, a 16.5 percent increase from 2010.

FIGURE 1.16.1, Full-time Employees Per 100,000 Form 2848 Authorizations Filed in the CAF and Total Forms 2848 Filed (In Millions) by Fiscal Year[20]



The IRS needs to improve its archaic systems and automate manual processing to expedite handling of Forms 2848. The IRS is considering an enterprise fax storage (EFS) solution that would receive and inventory faxed Forms 2848 in a computerized format, and distribute them to employees for processing. The IRS is still gathering requirements for EFS, and expects only incremental implementation between late FY 2013 and FY 2015.[21] (The CAF units have not scheduled any implementations at this time). Until the IRS fully and effectively automates the CAF units and generates Form 2848 acknowledgements, current processing will continue to undermine tax compliance and contribute to the CAF units' backlogs.

The National Taxpayer Advocate recommended in her 2010 Annual Report to Congress that the IRS implement a Correspondence Imaging System (CIS) to prevent CAF unit processing delays and actions that could harm taxpayers. The IRS already uses CIS as an inventory system, scanning all its Accounts Management (AM) receipts into digital images and working the cases from those images. Using CIS for correspondence and EFS for faxes would improve the receipt and control of all Form 2848 authorizations. However, because these systems will rely on employees' manual input of Forms 2848 to the CAF and IDRS, they would not fully automate the authorization process, alleviate the CAF units' staffing shortfalls, or expedite processing.

20 IRS response to TAS information request (Aug.10, 2012). IRS email updating response to TAS information request (Oct. 10, 2012). IRS, CDW, IDRS, analysis of IDRS BMF and IMF transaction code (TC) 960 for FY 2004 through FY 2012.

21 IRS response to TAS information request (Aug.10, 2012).

The IRS Must Protect Taxpayers' Rights as It Automates Form 2848 Processing.

The IRS e-Services disclosure authorization permits authorized representatives to electronically complete and file Form 2848 authorizations, view and modify existing forms, and receive acknowledgement of accepted submissions immediately — all online.[22] The IRS requires representatives submitting Forms 2848 electronically to retain the original signed form.[23]

In 2011, approximately 240,000 users filed almost 300,000 authorizations through e-Services.[24] However, the Treasury Inspector General for Tax Administration (TIGTA) surveyed these representatives and their clients, and found 20 percent of representatives could not produce the original signed Form 2848, and four percent of taxpayers did not give permission to submit the authorization.[25] The National Taxpayer Advocate is concerned that the IRS may have given some representatives unauthorized access to taxpayer information, or some practitioners may have represented taxpayers without authorization. Even as the IRS addresses these problems, however, it should continue to explore and develop electronic submission of Form 2848 authorizations to reduce manual processing, and retrain its employees to improve e-Service controls.

IRS's Elimination of CAF Unit Help Lines and Decline in PPS Service Could Place Taxpayer Information in the Wrong Hands and Deny Representation.

The IRS generally sends copies of all taxpayer correspondence to taxpayers' authorized representatives as provided by the CAF program, and indicated on the IDRS.[26] Taxpayers may revoke an authorization by

- Submitting a signed statement of revocation;
- Writing "revoke" on and signing a copy of the Form 2848 naming the representative to be revoked; or
- Giving a Form 2848 authorization to a new representative to file with the IRS.[27]

Further, representatives may change their address of record by submitting a signed statement to a CAF unit. When a CAF unit prolongs processing a change of address, revocation, or new Form 2848, the IRS continues to send taxpayer information to the previous address or representative.

Reduction of services and lengthy processing could lead to unauthorized disclosure of taxpayer information, or to taxpayers not receiving the representation they expected.

22 *See* http://www.irs.gov/Tax-Professionals/What-are-the-e-services-products%3F 10/ (last visited Oct. 5, 2012).

23 IRS, *Instructions for Form 2848* (Mar. 2012).

24 IRS response to TAS information request (Aug.10, 2012).

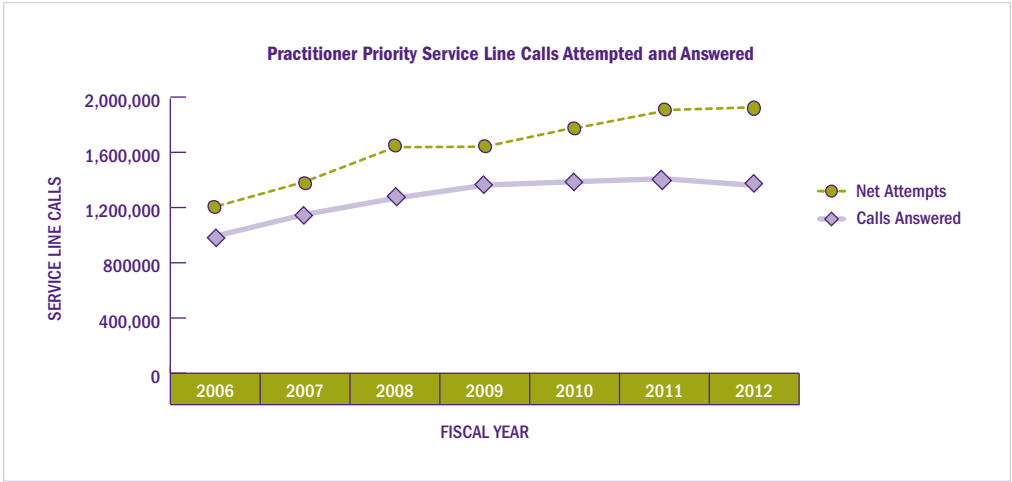
25 TIGTA, Ref. No. 2012-40-071, *Insufficient E-Services Controls May Put Taxpayer Information at Risk* 6-7 (June 29, 2012).

26 Treas. Reg. § 601.506(a).

27 IRS, *Instructions for Form 2848* 2 (Mar. 2012). The statement of revocation must indicate that the authority of the power of attorney is revoked, list the matters and periods involved, and must be signed and dated by the taxpayer.

However, the IRS has increased the risk of harm to taxpayers by increasing CAF units' processing time for a Form 2848, from two to five business days to ten calendar days or less, and by eliminating the CAF help lines.[28] The CAF help lines accepted calls from taxpayers to verbally authorize disclosure, and from practitioners to change their addresses, resolve authorization issues in the transcript delivery system, or follow up on Form 2848 filings.[29] The IRS now instructs practitioners to contact the PPS phone line for CAF unit inquiries.[30] As shown in Figure 1.16.2 below, the PPS phone line's level of service (the percentage of total calls answered) has declined steadily from 90 percent in FY 2006 to 73 percent in FY 2012, even as attempted calls have increased by 60 percent.[31]

FIGURE 1.16.2, Calls Attempted by Practitioners and Calls Answered by PPS Assistors for FY 2006 through 2012[32]



The PPS line assistors may provide taxpayers' transcripts of accounts to authorized practitioners, and receive faxes of Forms 2848 and address change requests. However, assistors do not have direct access to the CAF program, and must forward Forms 2848 or address change requests to the CAF units for processing. Under the IRS's current system, this extra step is unavoidable and creates additional delays in processing these time-sensitive forms and requests. The IRS maintains:

28 National Taxpayer Advocate 2010 Annual Report to Congress 171-186 (Most Serious Problem: *Persistent Breakdowns in Power of Attorney Processes Undermine Fundamental Taxpayer Rights*). IRS SERP, *Alert 12A0555: Centralized Authorization File (CAF) Help-line* (Oct. 2, 2012)

29 IRM 21.3.7.4.2, *Third Party Record Updates* (Oct. 1, 2008). IRM 21.3.7.6.7, *Oral Taxpayer Information Authorization (OTIA) Processing* (Oct. 1, 2008). IRM 3.42.8.8.6.1, *Rejected Transcript Delivery System (TDS)* (Oct. 1, 2010).

30 *See, e.g.,* IRM 3.42.8.8.6.1, *Rejected TDS* (Oct. 1, 2012); IRM 3.42.8.8.4.3, *CAF Unit Faxing* (Oct. 1, 2012).

31 LOS was 90 percent in FY 2006 for 1,095,241 net attempts (1,206,183 attempts less 110,942 attempts abandoned by callers), and 73 percent in FY 2012 for 1,747,217 net attempts (1,926,076 attempts less 178,859 attempts abandoned by callers). *See* IRS, Joint Operations Center, *Snapshot Reports: PPS* (weeks ending Sept. 30, 2006 and Sept. 30, 2012).

32 *See* IRS, Joint Operations Center, *Snapshot Reports: PPS* (weeks ending Sept. 30, 2006, Sept. 30, 2007, Sept. 30, 2008, Sept. 30, 2009, Sept. 30, 2010, Sept. 30, 2011, and Sept. 30, 2012).

> Submission of a POA [Form 2848 authorization] to the CAF is not a requirement for representation before the IRS. Any recognized representative may represent a taxpayer before any officer or employee of the IRS by providing that officer or employee with a copy of a valid POA, regardless of whether the POA has been recorded on the CAF. Recording a POA on the CAF is intended to enable IRS personnel who do not have access to the actual POA to act upon the POA (See Conference and Practice Requirements, Statement of Procedural Rules § 601.506(d)).[33]

Yet if the CAF units do not timely process Forms 2848, systems and employees that generate notices to taxpayers will not be able to send these notices to the right representatives or addresses. The National Taxpayer Advocate is concerned that elimination of the CAF unit help lines and increased burden on the PPS line will lead to further processing delays and unauthorized disclosures, and will deprive taxpayers of the representation they intended.

Taxpayers Are Harmed When LITCs Cannot Provide Timely Service.

When Congress created the LITC program, it recognized the need for low income taxpayers to have access to representation before the IRS and the courts.[34] The clinics, which are independent from the IRS, represent low income taxpayers before the IRS and assist them in audits, appeals, and collection disputes for free or no more than a nominal fee.[35] Each clinic determines whether prospective clients meet income eligibility guidelines and other criteria before agreeing to represent them. Further, LITCs operate under the scrutiny of TAS, the Government Accountability Office (GAO), and TIGTA, and are required to attend an annual conference conducted by TAS.[36]

Clinical programs operated by accredited law, business, or accounting schools and tax exempt organizations may use students to represent low income taxpayers in controversies with the IRS.[37] The students practice under the supervision of an attorney, CPA, or licensed EA who is authorized to represent taxpayers before the IRS.[38] To accommodate student practice, the IRS Office of Professional Responsibility (OPR) has been responsible for issuing an authorization for a special appearance, which must be submitted with the Form 2848 whenever a taxpayer authorizes a student who works in a LITC to be his or

33 National Taxpayer Advocate 2010 Annual Report to Congress 180 (*IRS Comments to Most Serious Problem: Persistent Breakdowns in Power of Attorney Processes Undermine Fundamental Taxpayer Rights*).

34 IRC § 7526; Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), § 3601(a), Pub. L. No. 105-206, 112 Stat. 758 (1998). The LITC program serves individuals whose income is below a certain level and require assistance with the IRS. Some LITCs only provide education and outreach, rather than representation, for individuals whose native languages are not English.

35 IRC § 7526(b)(2). *See* Publication 4134, *Low Income Taxpayer Clinic List* (Mar. 2012) for a listing of LITCs.

36 Publication 3319, *Low Income Taxpayer Clinics Grant Application Package Book* (May 2012).

37 IRC § 7526(b)(2). The IRS also has a program, pre-dating the LITC program, known as the Student Tax Clinic Program, which provides free tax assistance to taxpayers who need representation before the IRS on federal tax matters. Student Tax Clinics (STCs) are staffed by law, business, or accounting students. The key difference between LITCs and STCs is that LITCs are funded by federal grants provided in the Code, while the STCs do not receive federal grants. IRM 1.25.3.7(2) (June 1, 2010).

38 Treas. Dept. Cir. No. 230, 31 CFR, Subt. A, Pt. 10 (Circular 230) provides the rules for practice before the IRS.

her representative. [39] Effective December 5, 2012, the Acting Commissioner re-delegated the authority to issue student practice letters to the Director of the LITC Program Office in TAS.[40]

Student representatives typically participate in LITCs through the duration of the semester, and sometimes for longer periods in order to provide continuous service throughout the calendar year. Due to the nature of the academic calendar, new students enroll in clinics each semester or academic year. By contrast, resolution of a tax case can often take several months or even years. Although the clinic director provides continuity in taxpayer representation from semester to semester, multiple student representatives may assist a client during the life of the case. Form 2848 provides instructions on how to substitute representatives during an open case.

Line 5 of Form 2848 contains a box the taxpayer can check to authorize substitution or addition of representatives.[41] If a taxpayer signs an original Form 2848 with the substitution box checked, he or she is authorizing the representative to substitute a different representative without obtaining additional consent. In the case of LITCs operated by academic institutions, this procedure to authorize substitution of representatives is essential to ensure seamless and continuous representation. As discussed above, multiple student representatives may work on a client's case from the time the taxpayer retains the LITC until the problem is resolved. Further, low income clients of LITCs may be difficult to contact and it may not be feasible for them to make successive trips to the LITC office to sign additional forms.

If a taxpayer has checked box 5, the Form 2848 instructions call for the new representative to submit to the IRS a copy of the original Form 2848, signed by the taxpayer and authorizing substitution, along with the new Form 2848, which the taxpayer does not need to sign. In the case of students, the clinic must submit a copy of the special appearance authorization letter as well.

Despite the fact that student representatives are clearly authorized by IRC § 7526 to represent taxpayers, and IRS procedures authorize substitution of representatives, the clinics still encounter problems with the IRS's processing of Forms 2848 appointing student representatives. The CAF units often reject Forms 2848 listing student representatives, even when the clinics submit all of the proper forms. Some improper rejections may stem from the paper-driven environment of the CAF units that handle a large volume of Form

39 Circular 230 §10.7(d). Pursuant to longstanding practice dating back to the inception of STCs, OPR generally issued special order letters to the LITC director, who submitted the names of the student representatives, the tax coursework completed or in the process of being completed for each student, and the name and resume of the LITC director. IRM 1.25.3.7 (June 1, 2010). Students must attach a copy of a Special Appearance Authorization letter from OPR when submitting a Form 2848 to the CAF unit for processing. IRM 21.3.7.8.4 (Oct. 1, 2012).

40 Delegation Order 25-18 (Dec. 5, 2012).

41 Form 2848, *Power of Attorney and Declaration of Representative* (Mar. 2012).

2848 receipts. A clinic director seeking to substitute a new student representative for a graduating representative must submit three documents:

1. The original Form 2848, signed by the taxpayer and authorizing substitution of representatives;
2. The new Form 2848, detailing the substitution but not requiring a taxpayer signature; and
3. A copy of the special appearance authorization letter.

Any one of these documents submitted without the other two will cause the IRS to reject the request. Further, the IRS e-Services system is not equipped to accept Forms 2848 that have the substitution box on line 5 checked, making paper submission the only option. Yet if the clinic director submits the documents to the CAF unit by fax, a CAF employee may inadvertently separate one page from the others when pulling pages from the fax machine, causing the IRS to reject the request improperly.

When the CAF unit rejects a Form 2848, it paralyzes the student representative's ability to work a case. The IRS will not disclose taxpayer return information to the student representative unless a valid POA is in effect. This leaves the clinic director as the only clinic member who can communicate with the IRS on the taxpayer's behalf, which undermines the mission and structure of student clinics. A clinic director cannot personally handle all ongoing cases and the student is either not able to advocate on the taxpayer's behalf or complete work towards academic credit. As a result, the low income taxpayer is left without sufficient representation, the very deficiency Congress sought to remedy by authorizing student representation in IRC § 7526.[42] The National Taxpayer Advocate recommends creating a more reliable processing system in the CAF units to handle multiple document submissions to help alleviate this problem.

IRS operating divisions, which include the Automated Collection System (ACS) and AM, often deny properly authorized student representatives the right to advocate on a taxpayer's behalf. Even in cases where a student representative has a validly recorded Form 2848 on file, an IRS employee may be unaware of the statutory authorization for student representation and decline to discuss the case. While an abundance of caution in seeking to protect the taxpayer's confidential tax return information most likely motivates this action, the end result is to harm the taxpayer.

The student representation program affects a relatively small number of representatives, but it provides an invaluable service by affording free or nominal fee representation to taxpayers who cannot afford representation and who otherwise would be much less likely to obtain appropriate resolutions of their problems. The IRS already has procedures to accommodate statutorily authorized student representation. Now it needs to ensure those

42 S. Rep. No. 105-174, at 99 (1998). *IRS Restructuring: Hearings Before the S. Comm. on Finance on H.R. 2676*, 105th Cong. 124-126 (1998) (statement of Nina E. Olson, Executive Director, Community Tax Law Project).

procedures are properly implemented and raise awareness of the student representation program among IRS employees so its procedures are followed.

IRS Employees Do Not Always Adhere to IRC § 7521 Direct Contact Provisions.

The IRC and regulations generally prohibit the IRS from contacting represented taxpayers if a valid Form 2848 or other power of attorney authorization is on file.[43] If the IRS improperly bypasses a taxpayer's representative, the taxpayer may seek damages from the government by civil action under IRC § 7433 or report the IRS employee to TIGTA. However, the IRS provides no other relief or apology for violations of this rule, for example, by unwinding certain agreements or actions undertaken without the representative's involvement.

IRS employees are specifically required to obtain their immediate supervisors' approval to contact the taxpayer instead of the representative if the representative is unreasonably delaying an audit or investigation.[44] Violations of these rules have two causes:

1. A direct contact bypass occurs when an employee deliberately bypasses a representative to contact a taxpayer directly.
2. A systemic bypass is caused by an inadequate or malfunctioning IRS system.

TIGTA has examined systemic and direct contact bypasses to determine if the IRS violated taxpayer rights. For example, TIGTA reviewed a sample of Collection Field function (CFf) cases closed between April 1, and September 30, 2011 for direct contact bypasses, and estimated that revenue officers negatively affected the rights of 4,845 taxpayers by not following procedures and deliberately bypassing their representatives.[45] TIGTA recommended that the IRS provide greater assurance that its field collection employees afford taxpayers their rights to representation. IRS management agreed to issue a memorandum reinforcing the need for CFf personnel to follow procedures, and to clarify the Internal Revenue Manual (IRM) for adherence to these procedures when conducting case reviews.[46]

In 2009, TIGTA recommended that the IRS avoid certain bypasses by systemically uploading CAF data to the Automated Lien System (ALS) to ensure taxpayer representatives receive timely notice of lien filings and taxpayers' rights to appeal the lien action at a Collection Due Process (CDP) hearing.[47] The filing of a Notice of Federal Tax Lien (NFTL)

43 IRC § 6304(a)(2) prevents the IRS from directly contacting represented taxpayers in collection matters. IRC § 7521(c) provides that an IRS employee may not require a taxpayer to accompany a representative to an interview in the absence of an administrative summons issued to the taxpayer. Treas. Reg. § 601.506(b) prohibits an IRS employee from directly contacting a represented taxpayer unless a recognized representative has unreasonably hindered or delayed an examination, collection, or investigation by failing to furnish, after repeated requests, needed nonprivileged information.

44 IRC § 7521(b)(2) and (c).

45 TIGTA, Ref. No. 2012-30-089, *FY 2012 Statutory Review of Restrictions on Directly Contacting Taxpayers* 5 (Sept. 4, 2012).

46 *Id*. at 6.

47 TIGTA, Ref. No. 2010-30-072, *Additional Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (July 9, 2010). After filing the Notice of Federal Tax Lien (NFTL) in the public records, the IRS sends the taxpayer Letter 3172, *Notice of Federal Tax Lien (NFTL) Filing and Your Right to a Hearing Under IRC 6320*, including the NFTL filed, Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, and other publications concerning the collection and appeals processes.

may significantly affect a taxpayer's credit history, while giving the taxpayer only 30 days to appeal the filing to receive Tax Court review.[48]

Unlike other IRS notices that generate from the IDRS, lien notices come from the ALS, which is not linked to the IDRS or the CAF. The IRS significantly harms taxpayers' right to representation when it fails to provide time-sensitive hearing notices to representatives, as it has no authority to grant an additional hearing for review of the court.[49] However, the IRS delayed the corrective action, and in May of 2011, TIGTA estimated the IRS adversely affected 32,552 taxpayers by not notifying them and their representatives of hearing rights concerning liens.[50] On December 29, 2011, the Director of Collection Policy in the Small Business/Self-Employed (SB/SE) Division asked to have the corrective action rescheduled, which may occur before TIGTA reevaluates systemic bypasses in the ALS for FY 2013.

Again on May 29, 2012, TIGTA reported the IRS adversely affected an estimated 43,817 taxpayers because it did not notify their representatives of CDP hearing rights as required.[51] The IRS concurred with the number of taxpayers affected and agreed to corrective actions, but disagreed that the failure to notify representatives violated the taxpayers' rights because the IRS notified the taxpayers.[52]

The National Taxpayer Advocate strongly disagrees with the IRS's view that these actions did not violate taxpayer rights. She reminds the IRS that a representative cannot advocate for a taxpayer as requested, or provide representation in the taxpayer's absence as intended by Congress, unless the representative receives IRS notices. Especially in the context of Collection Due Process hearings, where the taxpayer has only 30 days to request the hearing and protect the right to challenge collection actions in the U.S. Tax Court, failure to provide the taxpayer's representative with a copy of the hearing notice can severely impede the taxpayer's access to fundamental statutory protections.[53]

In her 2010 Annual Report, the National Taxpayer Advocate recommended the IRS establish a process of gathering and tracking taxpayer and representatives' complaints about

48 National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*). IRC § 6320 provides that a taxpayer may request a hearing in writing within the 30-day period beginning the day after five business days from the filing of the first NFTL in relation to a specific tax debt. If a taxpayer timely requests a hearing, the taxpayer may seek U.S. Tax Court review of the notice of determination within 30 days after its issuance by Appeals.

49 Treas. Reg. § 301.6320-1(i) permits a taxpayer to request an equivalent hearing up to one year after the five business day period after the lien filing has passed. However, the taxpayer may not seek U.S. Tax Court review of the decision letter issued after the equivalent hearing. The court's jurisdiction under IRC § 6320 depends upon the issuance of a valid determination letter and the filing of a timely petition for review. *Kennedy v. Comm'r*, T.C. Memo. 2008-33.

50 TIGTA, Ref. No. 2011-30-051, *Challenges Remain When Processing Undelivered Mail and Preventing Violations of Taxpayers' Rights During the Lien Due Process* (May 20, 2012).

51 TIGTA, Ref. No. 2012-30-057, *Problems Persist When Processing Undelivered Lien Notices and Notifying Taxpayers' Representatives* (May 29, 2012).

52 TIGTA, Ref. No. 2011-30-051, *Challenges Remain When Processing Undeliverable Mail and Preventing Violations of Taxpayers' Rights During the Lien Due Process*; TIGTA, Ref, No. 2012-30-057, *Problems Persist When Processing Undelivered Lien Notices and Notifying Taxpayers' Representatives* (May 29, 2012).

53 IRC § 6330(d)(1); Treas. Reg. §§ 301.6320-1(f)(1) -(1)(i)(1) and 301.6330-1(f)(1) -1(i)(1).

direct contact violations and provide mandatory annual training for all contact employees.[54] The National Taxpayer Advocate renews her recommendation, and further recommends that TAS and the IRS form a workgroup to address improper systemic bypasses of taxpayers' representatives, provide taxpayer remedies for bypass violations, and specifically correct problems that deny taxpayers their fundamental right to representation.

CONCLUSION

In conclusion, the National Taxpayer Advocate preliminarily recommends that the IRS take the following steps:

1. The IRS should implement a comprehensive system to record, track, and automatically update the CAF and the IDRS to shorten Form 2848 processing time to two or three calendar days or less.
2. The CAF units should timely acknowledge the processing of all Form 2848 authorizations to prevent costly rework when a representative cannot determine if the IRS processed his or her request in a reasonable time.
3. The IRS should encourage practitioners to electronically file Form 2848 authorizations and retrain some of its employees to implement e-Service controls.
4. The IRS should reinstate the CAF unit help lines to enable representatives to update addresses and fix processing problems, and provide taxpayers the ability to make verbal authorizations.
5. The IRS should revise its e-Services system to allow submission of LITC student Form 2848 authorizations and LITC student representation substitutions.
6. The IRS should take measures to increase awareness of the student representation program among IRS operating divisions to help ensure that student representatives are appropriately recognized.
7. The IRS should gather and track taxpayer and practitioner complaints about direct contact POA bypass violations.
8. The IRS should provide mandatory annual training for all contact employees on how to avoid direct contact POA bypass violations.
9. The IRS should form a workgroup with TAS to address improper systemic bypasses of taxpayers' representatives, provide taxpayer remedies for bypass violations, and specifically correct problems that deny taxpayers their fundamental right to representation.

54 National Taxpayer Advocate 2010 Annual Report to Congress 186.

IRS COMMENTS

The IRS shares the interest of protecting taxpayers' rights to representation and supports improvement efforts upon identification of areas of deficiency in our operations. We have a number of policies and procedures in place to ensure taxpayers are afforded their right to designate a qualified representative to act on their behalf in dealing with IRS personnel in a variety of tax matters. These policies and procedures include official policy statements, IRM guidance, taxpayer publications, quality measurement reviews, and managerial oversight.

These policies and procedures are routinely reinforced through updates to the IRM and issuance of memoranda to front-line staff. For example, a memorandum was issued the week of November 25, 2012, reinforcing the need for field collection personnel to follow procedures and afford taxpayers their right to appropriate and effective representation throughout the field collection process. In addition, we recently revised language in field examination initial contact letters, Letter 2205 series, to make it clear that authorized representatives can attend all audit appointments on behalf of the taxpayer. The IRS will continue to take steps to ensure our employees and taxpayers are aware of direct contact provisions.

An authorized third party may represent a taxpayer before an officer or employee of the IRS by providing that officer or employee with a copy of a valid POA, regardless of whether the POA has been recorded on the CAF. Nonetheless, the IRS acknowledges that it experienced delays in the processing of POA and Tax Information Authorizations (TIA) in prior years due to increased receipts and limited resources. The IRS evaluated the CAF program to determine ways to reduce current processing timeframes. Based on the analysis, the IRS cross-trained additional employees on CAF processing. Additional resources will be applied to the program for the 2013 filing season. In order to track and further analyze the results of these efforts, we are exploring ways to systemically capture cycle time data. In the meantime, a manual reporting process was established. The most recent report shows the average days to process is four calendar days. Based on cross-training efforts and 2013 hiring allocations, we expect the improvement in processing time to continue.

The IRS discontinued the CAF Unit Help Lines in Ogden and Memphis. These toll lines were not able to provide the full level of customer service available to taxpayers. The CAF telephone numbers did not meet the general government criteria for help numbers such as having a quality review process in place and the fact that account related calls came to CAF assistors who were not fully trained to resolve them. To improve the level of customer service and allocate resources to the correct product lines, callers seeking assistance with CAF issues are now directed to the applicable individual or business account toll free telephone lines. This ensures all of the callers' issues are resolved and allows the CAF unit staff to focus solely on processing third party applications. CSRs staffing individual and business account lines are fully trained to respond to questions related to completion and filing of POAs and TIAs, as well as account related issues.

Further, the IRS is making improvements through technology. The e-Services Disclosure Authorization is available to qualified practitioners and provides for real time submission and acknowledgement of POAs and TIAs. We have taken steps to encourage more qualified practitioners to take advantage of the e-Services products available to them. We have also engaged the Internal Revenue Service Advisory Council (IRSAC) to assist in redirecting practitioners to IRS Automated Applications, and during 2012, the IRSAC reviewed the current situation and made recommendations for encouraging more practitioners to utilize automated services.

The IRS has also procured and installed new high-speed network printers in its three CAF Units, thus improving the efficiency of faxed receipts. This change has been transparent to the taxpayer, and has enabled CSRs to more competently assist taxpayers. If the new equipment should fail, the taxpayer is not harmed. Since the submission or recordation of a POA to the CAF is not a requirement for representation before the IRS, the authorized third party may represent a taxpayer before the IRS by a providing a copy of a valid POA to the IRS officer or employee.

With respect to LITCs, the importance of LITCs and student representatives is widely understood within the IRS. Since TAS first identified a problem many years ago, the IRS has invested in training and guidance to ensure proper recognition for student representatives. This multi-year effort included revisions to the Form 2848, its instructions, and CAF processes, as well as numerous changes to relevant IRM sections. We believe that the problems LITCs have experienced in this area have been reduced significantly.

In order to protect taxpayer data as required by IRC § 6103, the IRS has strict requirements for clinic directors seeking to substitute a student representative. LITC students are unlicensed individuals who, because of special appearance authorizations, are permitted to practice before the IRS. The students have not, by definition, completed the training and background checks that other Circular 230 practitioners have undergone in order to obtain their licenses.

With respect to the recommendation of the National Taxpayer Advocate that the IRS shorten Form 2848 processing time to two or three calendar days, the IRS is actively working to identify improvement opportunities for electronic submissions of third party authorizations. Disclosure Authorization is available to qualified practitioners and provides for real time submission and acknowledgement of POAs and TIAs. Until a systemic process is established to track processing time, we have implemented a manual reporting process for measuring cycle time.

The IRS does not believe that timely acknowledgement of Forms 2848 would reduce duplicate submissions, or rework. The IRS has invested time and resources to reduce processing time, a major driver in timely acknowledgements. Concurrently, Accounts Management convened a team to evaluate the cause of duplicate submissions and other rework conditions.

With respect to encouraging practitioners to electronically file Form 2848, we have taken steps to encourage more qualified practitioners to take advantage of the e-Services products available to them. We have engaged the IRSAC to assist in redirecting practitioners to IRS Automated Applications, and during 2012, the IRSAC reviewed the current situation and made recommendations for encouraging more practitioners to utilize automated services.

Based on recommendations from the IRSAC group, the IRS added four announcements that play during PPS wait/queue time promoting e-Services products available to practitioners. Electronic Products and Services Support is coordinating with W&I communications and the practitioner community on a comprehensive e-Services marketing plan to expand the promotion of e-Service capabilities, through multi-media and print methods. IRS is committed to increasing usage of e-Services Disclosure Authorization and will continue to promote the use of this automated system to practitioners during various presentations and speaking engagements coordinated through the Stakeholder Liaisons Office.

The National Taxpayer Advocate recommends that the IRS reinstate the CAF Unit Help Lines for CAF related issues. CSRs on the toll-free lines are trained to assist taxpayers with CAF related issues such as address changes, processing problems and completing verbal authorizations. Resources previously used to staff the CAF Help Line have been redirected solely to process third party applications.

The National Taxpayer Advocate recommends that the IRS allow LITC student representatives to use e-Services and increase awareness of the program in IRS operating divisions. While we acknowledge that "seamless" representation may be beneficial, such "seamlessness" cannot come at the expense of security of information and protection of taxpayer or practitioner data. The e-Services suite of products is designed for practitioners to help them communicate electronically with the IRS about their clients' issues. LITC students are unlicensed individuals who, because of special appearance authorizations, are permitted to practice before the IRS. The students have not completed the training and background checks that other Circular 230 practitioners have undergone to obtain their licenses. Because of the ever-growing threat of identity theft, it would be unwise to circumvent the e-Services system limitations and open e-Services to this population.

The importance of LITCs is widely understood within the IRS. The IRS has invested in training and guidance to ensure proper recognition for student representatives for many years, including revisions to the Form 2848, its instructions, and CAF processes, as well as numerous changes to relevant IRM sections.

The National Taxpayer Advocate recommends that the IRS track practitioner complaints regarding POA bypass violations and provide internal training on how to avoid such violations. Although even one violation of the provisions of IRC § 7521 is a matter of concern, the IRS has significant policies and procedures in place to mitigate the risk of inappropriate bypass. Given our continued efforts to ensure our employees adhere to the established policies and procedures, the IRS believes that establishing a separate and dedicated system

to gather and measure complaints on this issue would entail significant costs that outweigh the potential benefits. The IRS already conducts annual customer satisfaction surveys using a commercial vendor, which includes statistical data used to improve services. The Collection survey routinely queries taxpayers on whether they were treated fairly and the degree of courtesy and professionalism they received. Also, the survey includes a blank for comments from the taxpayer. These surveys do capture issues and/or complaints regarding direct contact issues, which the IRS analyzes and acts upon. In addition, taxpayers have the ability to file complaints regarding such abuses through Treasury Inspector General for Tax Administration TIGTA. Since direct contact provisions are statutory in nature, TIGTA can receive, respond to, and analyze such complaints. We will continue to provide guidance to our contact employees on the rules regarding adherence to POA procedures. In addition, we continue to solicit feedback from our external stakeholders for improvement opportunities.

The IRS provides multiple training portals for employees and managers that ensure they have appropriate guidance. We update the IRM and issue guidance memoranda to reinforce the importance of adhering to the processes designed to recognize taxpayer representation. We emphasize taxpayer rights with respect to direct contact provisions in training. In response to TIGTA findings, Field Collection plans to include additional emphasis on direct contact provisions in the upcoming FY 2013 Revenue Officer Continuing Professional Education (CPE). In addition, the campus operations will review CPE training material for their contact employees to ensure it includes information on how to avoid direct contact POA bypass violations. We believe our efforts in this area provide the appropriate guidance for our employees.

The IRS shares the interest of protecting taxpayers' rights to representation and supports improvement efforts upon identification of areas of deficiency in our operations. The IRS will continue to work with TAS in this effort. We will continue to monitor the issue and will make additional improvements as appropriate.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS is interested in protecting taxpayers' rights to representation and wants to improve operational deficiencies in its programs. We commend the IRS for issuing a memorandum in November about POA policies and procedures, but we encourage the IRS to consult with TAS on these important taxpayer rights as required in the IRM.[55] Similarly, we applaud the IRS's commitment to developing and conducting training about POA policies but we request that the IRS share this training with the National Taxpayer Advocate for comment prior to delivery. As the statutory "voice of the taxpayer" inside the IRS, TAS brings a unique perspective to these matters.

The National Taxpayer Advocate also commends the IRS for creating a process to report the timeliness of Form 2848 processing in the CAF units, and for organizing a team to evaluate the cause of duplicate submissions and other rework. However, the IRS seeks to minimize its accountability for untimely processing by stating, "An authorized third party may represent a taxpayer before an officer or employee of the IRS by providing that officer or employee with a copy of a valid POA, regardless of whether the POA has been recorded on the CAF." While this may be technically true, the harsh reality is that failure to timely record Forms 2848 on the CAF greatly increases the risk that taxpayers' representatives will not receive notice of imminent enforcement actions with short due-dates, including the Statutory Notice of Deficiency and Collection Due Process notices.

Taxpayers who have exercised their fundamental right to be represented by counsel or other tax professionals have the reasonable expectation the IRS will honor that right by informing the representative of all government action or pending actions against the taxpayer — otherwise the right to representation is meaningless. The IRS cannot avoid this responsibility by holding the taxpayer accountable for telling its representative about government action about which the government itself has publicly stated it will inform the representative. This sort of circular reasoning does not stand, and it violates the taxpayer's right to representation.

The IRS also avoids accountability for the CAF units' processing by eliminating the help lines that practitioners and taxpayers could use to follow up on Form 2848 problems. The IRS explains that those lines did not provide the "full level of customer service available to taxpayers," because they had no quality review process and the assistors were not fully trained to handle account-related calls. However, the CAF unit help lines provided practitioners and taxpayers firsthand contact with IRS personnel who processed Forms 2848 or taxpayer information authorizations. Callers with account-related issues could have easily been transferred to account-related lines immediately after CAF unit issues were addressed. The National Taxpayer Advocate is disappointed that the IRS unilaterally shut down the help lines without vetting the decision with TAS, or with the practitioners and taxpayers

[55] IRM 1.11.9.4 (Nov. 1, 2011).

who may have used this important service. We are not convinced that a general help line, acting as an intermediary to the CAF units, will effectively resolve all CAF-related issues or provide the highest level of taxpayer service.

The National Taxpayer Advocate commends the IRS for attempting to redirect practitioners to use e-Services to file Forms 2848, and supports the updating of equipment to improve the processing of faxed forms. However, she disagrees that taxpayers are not harmed when new equipment fails. As noted above, if the IRS does not timely process a taxpayer's Form 2848 or revocation of Form 2848, the taxpayer may lose valuable time to appeal an IRS determination, may have his or her information given to an unauthorized practitioner, or an IRS employee. Further, a practitioner whose Form 2848 is not processed may waste valuable time proving he or she represents the taxpayer despite submitting a proper Form 2848 to the CAF unit. For these reasons, the IRS needs to acknowledge processing of Forms 2848.

In its response, the IRS asserts that "LITC students are unlicensed individuals who, because of special appearance authorizations, are permitted to practice before the IRS." In fact, it is not the IRS that has granted students in academic LITCs the authority to practice before the IRS. Rather, Congress statutorily authorized students to practice before the IRS under IRC § 7526(b)(2)(A), which defines a clinic as, among other things, "a clinical program at an accredited law, business, or accounting school in which students represent low-income taxpayers in controversies arising under this title...."

Thus, the ability of students to represent taxpayers before the IRS as part of an academic clinical program is a unique and a special privilege *granted by Congress*. The LITC Program Office in TAS awards LITC grants to academic and other institutions, and as part of that process, TAS determines whether the academic program provides adequate education, supervision, and safeguards for student representation.[56] Once the LITC Program Office makes that determination and enters into a grant agreement with the clinic, the IRS's issuance of Student Practice Letters is a formality — an important one, but a formality nonetheless. Continuing oversight of the academic clinic with the terms of the grant — including education and supervision of its students — rests in the LITC Program Office. It is for this reason that the Acting Commissioner redelegated the authority to issue Student Practice Letters from OPR to the Director of the LITC Program Office in TAS. [57]

As Congress intended, special appearance authorizations for student practice confer on the student the authority to represent taxpayers before any IRS office, and students authorized to practice can perform any and all acts listed on a Form 2848. Therefore, students should be treated the same as other practitioners.

56 *See* Publication 3319, *Low Income Taxpayer Clinics Grant Application Package Book* (May 2012).

57 Delegation Order 25-18 (Dec. 5, 2012).

Among the goals of the clinic experience are to teach students the proper way to practice in a controlled environment, to help them identify and resolve ethical issues in tax practice, and to comply with standards of professional conduct, such as confidentiality requirements. The LITCs have adequate safeguards to ensure the integrity of that mission. The LITC director or other responsible clinic official, who is himself or herself authorized to practice as an attorney, CPA, or enrolled agent, has the primary and absolute responsibility to monitor student POAs and a duty of care to their clients and the IRS according to Circular 230.[58] Moreover, the LITCs operate under the careful watch of TAS, the Government Accountability Office, and TIGTA.[59] For all of these reasons, as well as the mission of the clinics, LITCs require special rules to protect taxpayers without placing additional burden on the clinics or the CAF units.

The IRS has expressed reservations about expanding student access to e-Services because it is concerned the confidentiality of sensitive taxpayer information may be jeopardized. While the National Taxpayer Advocate acknowledges that identity theft is a growing problem for taxpayers and the IRS, access to e-Services by student practitioners would not increase the risk of identity theft. Whether a student practitioner or any other authorized practitioner processes authorizations or obtains taxpayer account information electronically through e-Services or from other IRS sources, the risk of unauthorized disclosure remains the same. Balancing the advantages that e-Services would provide to LITCs, student representatives, and the vulnerable taxpayers they represent, against the risk of potential unauthorized disclosure, should weigh in favor of allowing LITCs to use the e-Services system to allow submission of LITC student Form 2848 authorizations and LITC student representation substitutions.

The National Taxpayer Advocate does not believe that the IRS's policies and procedures to mitigate the risk of improper POA bypass are adequate to prevent continued violations of taxpayers' right to representation. The IRS has no way of knowing the impact of these violations without a system or process to record and report violations when they occur. It is highly unlikely that a customer satisfaction survey that queries taxpayers on whether they were treated fairly and the degree of courtesy and professionalism they received will identify these violations. By the time the survey is given, taxpayers may have been harmed by the inappropriate bypass of their representative through the filing of liens, levies, or other enforcement actions. While taxpayers' representatives can identify bypass violations, this may come too late to file a timely appeal or otherwise act to remedy the situation. Although TIGTA may be able to punish IRS employees for violations, the taxpayer will still have no way to restore rights that have been violated. The National Taxpayer Advocate commends the IRS for updating the IRM, issuing memoranda, and providing training to

58 Circular 230. A copy of the special order authorizing practice before the IRS must be attached to the power of attorney form (Form 2848) and submitted to the CAF unit. See IRM 21.3.7.9.6 (Oct. 26, 2009); IRM 5.1.10.5.2 (Aug. 21, 2006).

59 TAS oversight includes an extensive application process, including checks for suspension or disbarment and tax compliance of the sponsoring organization, reviews of interim and annual reports, and site assistance visits at least once every three years to identify best practices and assure compliance with the LITC grant award and program guidelines.

avoid these violations. However, the IRS should track bypass violations and give TAS a seat at the table to advocate for taxpayers and provide the taxpayers' perspective on protecting their rights.

Recommendations

The National taxpayer Advocate recommends that:

1. The IRS implement a comprehensive system to record, track, and automatically update the CAF and the IDRS to shorten Form 2848 processing time to two or three calendar days or less.
2. The CAF units timely acknowledge the processing of all Form 2848 authorizations to prevent costly rework when a representative cannot determine if the IRS processed his or her request in a reasonable time.
3. The IRS encourage practitioners to electronically file Form 2848 authorizations and retrain some of its employees to implement e-Service controls.
4. The IRS reinstate the CAF unit help lines, along with quality controls and the ability to transfer calls in and out, to enable representatives to update addresses and fix processing problems, and provide taxpayers the ability to make verbal authorizations.
5. The IRS revise its e-Services system to allow submission of LITC student Form 2848 authorizations and LITC student representation substitutions.
6. The IRS work with the National Taxpayer Advocate to increase awareness of the student representation program among IRS operating divisions to help ensure that student representatives are appropriately recognized.
7. The IRS gather and track taxpayer and practitioner complaints about direct contact POA bypass violations.
8. The IRS collaborate with TAS to provide mandatory annual training for all contact employees on how to avoid direct contact POA bypass violations.
9. The IRS form a workgroup with TAS to address improper systemic bypasses of taxpayers' representatives, provide taxpayer remedies for bypass violations, and specifically correct problems that deny taxpayers their fundamental right to representation.

MSP #17 The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services

RESPONSIBLE OFFICIAL

Peggy Bogadi, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

As the IRS strives to provide service to all taxpayers, balancing the diverse needs of taxpayers within the confines of existing resource constraints is crucial. Taxpayer Assistance Center (TAC) resources are in great demand, with 397 TACs serving over six million taxpayers in fiscal year (FY) 2012.[1] TACs provide the main means through which taxpayers receive in-person service from IRS employees. Certain groups of taxpayers prefer TAC assistance for various reasons:

- *Lack of personal computers and Internet access*: Twenty-four percent of Americans do not own a personal computer;[2] and 22 percent do not access the Internet.[3]
- *Internet security and identity theft concerns*: Approximately 44 percent of taxpayers are insecure about sharing any personal information on the Internet.[4]
- *Education, income, age, disability, and language barriers:* Individuals who have less than a high school education, are elderly, live in households with income of under $30,000 per year, are disabled, or speak English as a second language are less likely to have Internet access.[5]

The segments of the taxpayer population that are least likely to use Internet services, and to have any Internet access overall, constitute extremely vulnerable groups that most need face-to-face TAC services.

A recent Taxpayer Advocacy Panel (TAP) survey shows that many taxpayers attempt to complete their tax-related tasks through channels other than TACs, but eventually visit a TAC when they cannot resolve their issues by phone or online. During one week in

1 IRS, Wage and Investment (W&I) Division Business Performance Review, 3rd Quarter – August 15, 2012, *Customer Assistance, Relationships and Education (CARE) Performance Measures*, 20. These numbers are estimates as the IRS anticipates serving 6,070,000 taxpayers at TACs in FY 2012. The current number of TACs is 397 as the IRS closed the Jersey City, NJ TAC in July 2012. E-mail from Lashawne King, Senior W&I Program Analyst (Dec. 10, 2012).

2 Kathryn Zickuhr, Pew Internet, *Generations and Their Gadgets* (Feb. 2011), http://www.pewinternet.org/Reports/2011/Generations-and-gadgets.aspx.

3 Kathryn Zickuhr, Aaron Smith, Pew Internet, *Digital Differences* (Apr. 2012), http://www.pewinternet.org/Reports/2012/Digital-differences.aspx.

4 W&I Taxpayer Experience Survey, Tax Year 2009, Filing Season 2010 24 (May 2011). Additional reasons American adults report for not using the Internet include: just not interested, don't have a computer, too expensive, and too difficult. Kathryn Zickuhr, Aaron Smith, Pew Internet, *Digital Differences* (Apr. 2012), http://www.pewinternet.org/Reports/2012/Digital-differences.aspx.

5 *Id*. PEW found Internet use as of 2011 remains strongly correlated with age, education, and household income, forming the basis for the strongest predictors of use among all factors studied.

April 2012, the TAP surveyed over 650 taxpayers in line at more than 30 TACs, and found that almost 60 percent had already tried to use the IRS website or phone lines.[6]

By failing to pursue research into the impact of its policy shifts, the IRS continues to make changes in a vacuum without fully understanding their effect and burden on taxpayers, including re-work for both the taxpayer and the IRS. For example, in 2012 the IRS reduced the number of days it offered tax return preparation in the TACs and stopped accepting appointments for return preparation. This change may have been a factor in the 50 percent decrease in the number of e-file returns prepared and accepted by TACs.[7] The IRS did this despite growing evidence of return preparer fraud and the greater accuracy of TAC-prepared returns.[8]

ANALYSIS OF PROBLEM

Background

The IRS provides face-to-face taxpayer services in 397 TACs or local "walk-in" offices across the country.[9] IRS estimates more than six million taxpayers visited a TAC in fiscal year (FY) 2012, with similar numbers anticipated for FY 2013.[10] In the past, by visiting a TAC, taxpayers could pick up forms and publications, seek guidance about tax laws, request transcripts or other account information, seek assistance with IRS notices, make tax payments, and have their returns prepared.[11] Services provided at the TACs have declined

6 The TAP is a federal advisory committee comprised of citizen volunteers who work to improve IRS services by providing the taxpayers' perspective to various IRS operations. This survey effort was supported by the National Taxpayer Advocate and her Research and Systemic Advocacy staffs. TAP volunteers returned 664 completed surveys from 33 different TAC offices. While these results are not statistically representative of all TAC visitors, they represent the needs and activities of a sizable number of TAC customers during one week in the tax filing season. Percentages shown are out of all 664 respondents. Some respondents did not answer every question. Twenty-five percent of survey respondents attempted to call the IRS before visiting a TAC and 34 percent attempted to find an answer on IRS.gov.

7 IRS, *Field Assistance E-File Report* (Apr. 2012). In filing season 2011 (through April 4, 2011), 113,387 returns were e-filed in the TACs compared to just 55,958 in filing season 2012 (through April 2), a 50.6 percent decline. *Id*. For a further discussion of the National Taxpayer Advocate's concerns about return filing, see Most Serious Problem: *The IRS has Failed to Make Free Return Preparation and Free Electronic Filing Available to All Individual Taxpayers, infra/supra*.

8 For further discussion of the National Taxpayer Advocate's concerns about return preparer fraud, see Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully, infra/supra*.

9 The current number of TACs is 397 as the IRS closed the Jersey City, NJ TAC in July 2012. E-mail from Lashawne King, Senior W&I Program Analyst (Dec. 10, 2012).

10 W&I Business Performance Review, 3rd Quarter – August 15, 2012, *Customer Assistance, Relationships and Education (CARE) Performance Measures*, 20. Anticipated number of Taxpayer Assistance Center (TAC) contacts in FY 2012 is 6,070,000, with the target for FY 2013 at 5,465,000.

11 IRS, Field Assistance Concept of Operations 2 (Aug. 3, 2001). The IRS prepares Form 1040, *U.S. Individual Income Tax Return*, for taxpayers at no charge and based on need.

since 2004.[12] These changes in 2012 have further reduced taxpayer access to TACs from June 2010 levels in several ways:

- TACs were not open to support Earned Income Tax Credit Saturdays;[13]
- Three TAC offices closed;[14]
- Seven TAC offices have no current staffing, one office has only one employee (compared to June 2010 levels) and six additional TAC offices now only have two employees;[15] and
- TACs have expanded services by accepting identity theft documentation[16] in person but have not increased staff levels, thereby diluting available resources for traditional TAC services.

The IRS anticipates taxpayers will have to wait longer for help, have their access to services cut off earlier in the day to avoid end-of-day overtime, and may find small TACs unexpectedly closed due to employee absences.[17] Despite the continued reduction in TAC service, the National Taxpayer Advocate recommends a two-pronged approach to providing taxpayer services — through technology and face-to-face communication in a TAC.

Taxpayer Needs and Preferences Should Drive IRS Services.

Taxpayers have different needs, preferences, and expectations for interacting with and receiving service from the IRS. Some taxpayers are more likely to use the Internet to find forms and publications and gain an understanding of their tax law obligations. Others are more likely to visit the IRS in person to accomplish these tasks, including those who have low income or limited English proficiency, and the elderly.[18] Although Internet use has increased since 2006, when 71 percent of U.S. households accessed the Internet at least once a

12 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2012-40-036, *Interim Results of the 2012 Filing Season*, (Mar. 30, 2012). For a further discussion, see National Taxpayer Advocate 2002 Annual Report to Congress 95-103 (Most Serious Problem: *Free U.S. Individual Income Tax Return Preparation*); National Taxpayer Advocate 2003 Annual Report to Congress 145-51 (Most Serious Problem: *Taxpayer Assistance Centers*); National Taxpayer Advocate 2004 Annual Report to Congress 8-25 (Most Serious Problem: *Taxpayer Access – Face-to-Face Interaction*); National Taxpayer Advocate 2005 Annual Report to Congress 2-24 (Most Serious Problem: *Trends in Taxpayer Service*); National Taxpayer Advocate 2007 Annual Report to Congress 162-82 (Most Serious Problem: *Service At Taxpayer Assistance Centers*); National Taxpayer Advocate 2008 Annual Report to Congress 95-113 (Most Serious Problem: *Taxpayer Service: Bringing Service to the Taxpayer*).

13 The IRS and its coalition partners use Earned Income Tax Credit (EITC) Super Saturday events to increase awareness and participation in the EITC by eligible workers. For example, in 2009 the IRS opened over 250 TAC offices from 9 a.m. to 2 p.m. on Saturday, March 21 to support this initiative. *See* IRS News Release IR-2009-25, *IRS Partners Mark Super Saturday March 21 to Help Taxpayers*.

14 W&I Business Performance Review, FY 2012 Qtr. 1, 5 (Feb. 15, 2012).

15 *Id*. Fifteen offices are unstaffed, 36 offices have only one employee, 115 TACs have two employees, and 232 or 58 percent of TACs have three or more employees as of January 14, 2012. For a complete discussion of the reduction of service during the 2012 filing season, see National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress, *Filing Season Review*, 43 (June 2012).

16 *See* Internal Revenue Manual (IRM) 21.3.4.31, *Identity Theft Overview* (Oct. 1, 2012).

17 TIGTA, Ref. No., 2012-40-036, *Interim Results of the 2012 Filing Season* (Mar. 30, 2012).

18 IRS, 2007 Taxpayer Assistance Blueprint Phase II, 111.

month compared to 84 percent in 2012, some taxpayers still need face-to-face help with IRS notices, payments, and filing timely tax returns.[19] Of adults who are online:

- 61 percent complete banking activities online;
- 71 percent shop;
- 64 percent use social networks; and
- 91 percent check email.[20]

Use of online banking, a task most closely related to IRS activities, strongly correlates with age, income, and education levels. Adults with lower income levels, less than a high school education, and those over the age of 65 are the least likely to use the Internet for banking.[21]

TAP Survey Demonstrates Needs of TAC Users.

In April 2012, members of the Taxpayer Advocacy Panel surveyed taxpayers waiting for assistance in more than 30 TACs across the country. The survey was designed to gather information on customers' reasons for visiting the TAC, what other efforts they had made to resolve their issues, and their use of and comfort with various types of technology.[22] Responses suggest that even though these taxpayers tried to use different service channels, they still needed face-to-face help from a TAC. Taxpayers' reasons for visiting a TAC vary depending on time of year. The most frequently mentioned reasons were:

- To get an answer to a tax question;
- Obtain tax forms, instructions, or publications; or
- To resolve an issue related to an IRS notice or letter.

Figure 1.17.1 displays the responses to the TAP survey's question regarding contact with the IRS prior to visiting the TAC.

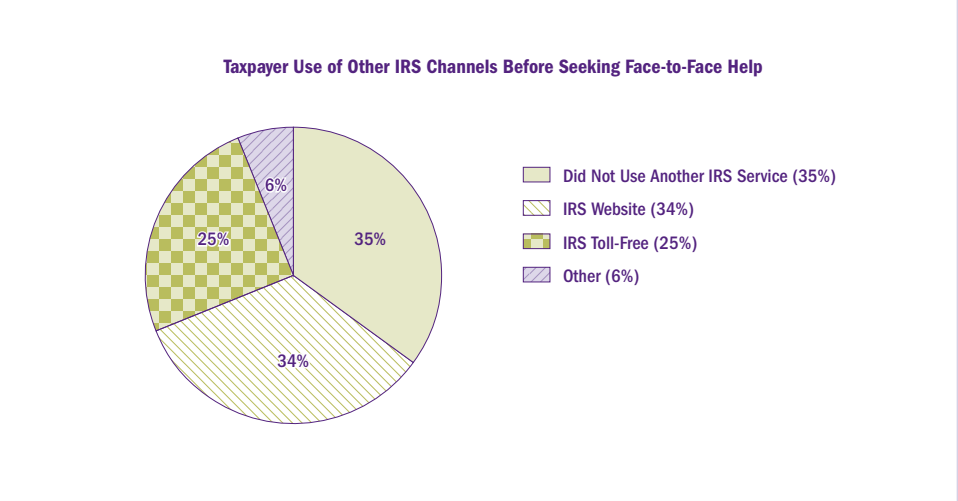
19 Forrester Research, Inc., North American Benchmark Mail Survey, Q2 2006. Seventy-one percent of U.S. households, 18 years of age and over, were accessing the Internet at least once a month from home, work, or elsewhere. *Id*. Eighty-four percent of US households, 18 years of age and over, are accessing the Internet at least once a month from home, work, or elsewhere. Forrester Research, Inc., North American Technographics Benchmark Survey, Q3 2012.

20 Kathryn Zickuhr, Aaron Smith, *Pew Internet, Digital Differences* 13 (Apr. 2012), http://www.pewinternet.org/Reports/2012/Digital-differences.aspx.

21 *Id*. Pew found that only 44 percent of adults over the age of 65 bank online, only 32 percent of adults with less than a high school education bank online, and only 42 percent of adults with household incomes of less than $30,000 per year bank online.

22 The TAP is a federal advisory committee comprised of citizen volunteers who work to improve IRS services by providing the taxpayers' perspective to various IRS operations. The National Taxpayer Advocate and her Research and Systemic Advocacy staffs provided support to this survey effort. TAP volunteers returned 664 completed surveys from 33 different TAC offices. While these results are not statistically representative of all TAC visitors, they represent the needs and activities of a sizable number of TAC customers during one week in the tax filing season. Percentages shown are out of all 664 respondents. Some respondents did not answer every question.

FIGURE 1.17.1, Taxpayer Use of Other IRS Service Channels Before Seeking Face-to-Face Help[23]



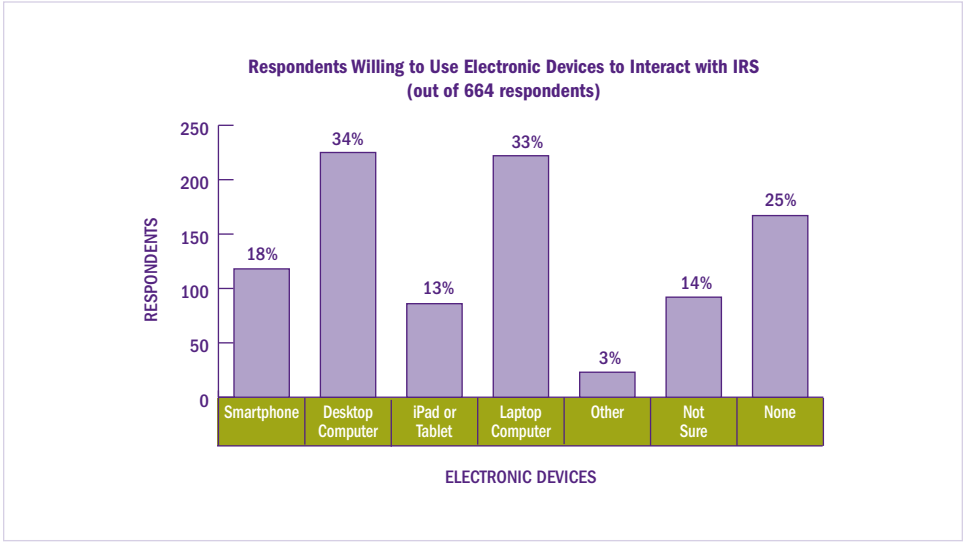
Only about one of every three of these taxpayers had not contacted the IRS by some other method before coming into the office, about 34 percent had visited the IRS website prior to visiting the TAC, and about 25 percent had phoned first. About one of every three respondents said they would be willing to interact with the IRS virtually (using a computer screen similar to Skype™), about 40 percent were not willing to interact with the IRS virtually, and another 26 percent did not reject the idea but were unsure if they would use such a service.[24]

Figure 1.17.2 displays the numbers of taxpayers who reported they were willing to use each of the surveyed electronic devices to interact with the IRS.

23 2012 TAP Survey of IRS Customers (Apr. 2012). Two customers tried to contact the IRS using more than one additional service channel.

24 *Id.*

FIGURE 1.17.2, Methods Taxpayers Will Use To Interact With IRS[25]



While a number of participants responded positively to the idea of using technology to communicate with the IRS, more than one of four indicated they do not have Internet access at home, rated their computer or Internet skills as "limited" or below, or said they would not use computers or smartphones to interact with the IRS. These findings provide further evidence that in-person services at TACs are still needed.[26]

The IRS could expand on the TAP survey as part of a comprehensive evaluation of taxpayers who visit TACs. Because taxpayer needs fluctuate through the year, a study that encompassed a full year would allow the IRS to find out what activities taxpayers come to TACs for, whether they had attempted to use other IRS services first, and why they were unable to use other channels successfully. Knowing what taxpayers would be willing to do through other channels can assist the IRS in deciding what other tools to offer, such as e-filing an amended tax return or having immediate access to an account transcript online. This could allow the IRS to focus TAC services on items that taxpayers expect to accomplish in an in-person face-to-face environment and ease the burden on TAC resources. Without rigorous research and analysis on the effect and burden of taxpayer service policy changes, the IRS will continue to make decisions that fail to consider the true needs of taxpayers.

25 2012 TAP Survey of IRS Customers (Apr. 2012).

26 *Id.*

Implementing a Ranking System of IRS Services Can Assist the IRS in Prioritizing Resource Allocation and Identifying Gaps in Research

At the request of the National Taxpayer Advocate, the Wage and Investment division has worked with TAS on the Service Priorities Project to develop a ranking methodology for IRS taxpayer services.[27] The goal of the project is to identify, from both the government and the taxpayer perspectives, the value of each taxpayer service offered by the IRS. By using existing data and identifying gaps, the IRS could use this ranking tool to allocate scarce resources based on the highest valued services. The ranking tool would consider factors such as:

- Issue resolution;
- Accuracy of service provided;
- Customer satisfaction;
- Taxpayer time spent getting the service;
- Awareness of the offered service; and (as proposed by TAS)
- Taxpayer willingness to use the service, its usage by vulnerable taxpayer populations such as the elderly or low income, and the relative impact on taxpayers who do not receive the service they request through a particular channel.

To populate the tool, the IRS must develop values for each of the ranking criteria. Some of this information is readily available for services offered by the IRS, such as taxpayer wait time when calling the IRS. However, the IRS will need to collect other information through surveys and increased tracking of service contacts. By identifying these information gaps, the ranking tool will easily allow the IRS to see areas where it needs to do additional research and analysis to determine how taxpayer services are being used and how taxpayers would like to use these services. Continuing research to populate the ranking tool will help the IRS to understand the best ways in which to deliver each type of service to the taxpayer and to optimize its overall taxpayer service strategy.

W&I and TAS have been unable to reach an agreement on the inclusion of TAS's proposed measures in the ranking tool. As a result, the IRS decided how to allocate resources for the 2013 filing season without the benefit of this ranking. Additionally, W&I declined the request of the National Taxpayer Advocate to discuss the preliminary ranking results at the October 2012 meeting of the IRS Services Committee.[28]

IRS Policies Impact Taxpayer Assistance Center Service Delivery.

Policy Changes Severely Reduced Tax Return Preparation in FY 2012.

Beginning with the 2012 filing season, TACs reduced the number of days they offered tax return preparation and no longer scheduled preparation appointments in advance. Instead,

27 See Exhibit 1 for a sample ranking template.

28 Email from Robin Canady to Nina Olson, National Taxpayer Advocate (Oct. 2012), on file with TAS Systemic Advocacy.

the offices helped taxpayers on a first-come, first-served basis.[29] This change may have been a factor in the 50 percent decrease in the number of e-file returns prepared and accepted by TACs.[30] The IRS failed to conduct research to determine how the taxpayers who relied on TACs to prepare their returns in previous years completed their returns in this filing season, and it thus missed an important opportunity to study the downstream consequences of this major policy change.[31] Nor did the IRS use this opportunity to determine if these returns were less accurate than those previously prepared by the TACs. Generally, returns prepared by TACs, where the taxpayers have a household income of less than $50,000 and do not use schedules E or F or Form 2106, have lower Discriminant Function (DIF) scores than returns prepared by other preparers or by taxpayers, suggesting that TAC-prepared returns are less likely to understate the tax owed and are thus more accurate.[32] By failing to pursue research into the impact of its policy changes, the IRS continues to make these changes in a vacuum without fully understanding their effect and burden on taxpayers, including re-work for both the taxpayer and the IRS.

In the past, taxpayers with appointments were guaranteed to be helped the day of the appointment, and the IRS could gauge the need for assistors when appointments were scheduled. Denying appointments negatively impacts taxpayers, particularly those who do not have paid time off from work, those who must travel long distances to reach a TAC, and elderly or disabled taxpayers who have difficulty getting to their local TAC. The IRS plans to continue this new policy in the 2013 filing season. The National Taxpayer Advocate suggests that the best option for the IRS and taxpayers alike is to use a combination of scheduled appointments for taxpayers who call in advance and are traveling long distances to the TAC and first-come, first-served appointments for others on the day they visit the TAC.[33]

Cutting bulk submissions of tax returns would have harmed tax preparers.

During the filing season and throughout the year, tax preparers commonly go to TACs to submit multiple returns, sometimes even hundreds at a time, in order to receive a date-stamped copy of the first page of each return. The IRS refers to this practice as "bulk submission." In preparation for the 2012 filing season, the IRS changed Internal Revenue Manual (IRM) 21.3.4.8, *Receipt of Tax Returns*, to indicate that TACs would no longer accept

29 TAC managers have discretion to make an exception to the policy and schedule an appointment on a case-by-case basis. *See* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress, *Filing Season Review* 44 (June 2012).

30 IRS, *Field Assistance E-File Report*, April 2012. In filing season 2011 (through April 4, 2011) 113,387 returns were e-filed in the TACs compared to just 55,958 (through April 2) in filing season 2012, a 50.6 percent decline. For a further discussion of the National Taxpayer Advocate's concerns about return filing, see Most Serious Problem: *The IRS has Failed to Make Free Return Preparation and Free Electronic Filing Available to All Individual Taxpayers*, *infra*/*supra*.

31 IRS response to TAS research request (Oct. 31, 2012). The response indicated that W&I did not track where the 50 percent of taxpayers who came to a TAC during the 2011 filing season actually went to get their tax returns e-filed in the 2012 filing season.

32 Compliance Data Warehouse, *Individual Returns Transaction File: Tax Year 2010*. TAC criteria for return preparation include returns with income not in excess of $50,000, and no schedules E, F, or Forms 2106, in addition to other requirements. The DIF score is an IRS calculated estimate of the likelihood that a tax return has understated the amount of tax owed, based on the type of return filed. The only returns that have lower DIF scores than TAC-prepared returns with the caveats listed above are those in Activity Code 272, which are returns with no Schedules C, E, F, or Form 2106 and no claiming of the Earned Income Tax Credit.

33 *See* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress, *Filing Season Review* 42-45 (June 2012).

bulk submissions from preparers. The IRS amended this procedure by March 2012, at the urging of the National Taxpayer Advocate, to provide exceptions to the general rule.[34]

Inability to accept cash payments harms taxpayers.

The IRS requires three separate employees to complete a cash transaction, which is why TACs with only one or two employees do not accept cash payments.[35] TACs that are not accepting cash must post Publication 4996, *Making a Payment — No Cash Accepted Poster — Field Assistance Taxpayer Assistance Centers* (see image below), and IRS.gov must be updated to reflect the inability of the TAC to accept cash.[36] This harms any taxpayer who must travel a long distance to a TAC to make a cash payment, or who can only visit the TAC during a narrow timeframe, particularly taxpayers who are "unbanked" and have no other way to pay their taxes. Unless the taxpayer has checked IRS.gov in advance or previously visited the TAC, he or she would not know that this location could not accept the cash payment. Likewise, if a three-person TAC became a two-person TAC due to an unscheduled employee absence, a taxpayer would not be able to make a cash payment on that day.[37] Although it may be a rare occurrence, for a taxpayer who drove a long distance to make the payment, it is a frustrating inconvenience and can result in additional penalties and interest, despite the taxpayer's efforts to make a payment.

Figure 1.17.3 (next page) shows a TAC counter with a sign on top that reads "Welcome to Taxpayer Assistance" and taped to the desk below a sign reads "No cash payments today. We're sorry for the inconvenience."

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34 IRM 21.3.4.8, *Receipt of Tax Returns* (Oct. 11, 2012). The IRM provides the following exceptions to the return acceptance policy:

- Returns received from taxpayers (non-preparers).
- Tax Returns received with remittance.
  - Field Assistance (FA) employees will accept tax returns with remittances. Remittances must be processed within the 24 hours deposit standard.
  - FA employees will provide the Tax Return Preparer information on making payments on behalf of their clients using EFTPS and the electronic filing options.
- Form 4868.
- Any individual or business extension forms can be accepted at any time, not limited to the due date only.
- Forms 4506-T.
- Imminent Refund Statute Expiration Date (RSED).
- Past-year returns (nonfilers), and routine returns when the preparer has traveled a significant distance or waited a long time.
- Managers have full authority to accept returns from preparers, on a case by case basis in their individual TACs, when it is in the best interest of the IRS or taxpayer hardship.
- Preparers are still required to provide a transmittal list or copies of their client's returns if they are requesting "proof of filing" per IRM 21.3.4.8.2, *Receipts for Tax Returns*. ***NOTE:*** The policy of not accepting tax returns from preparers is not intended to limit assistance to taxpayers or their authorized representatives, particularly in situations where the taxpayer is facing financial harm or undue hardship (*e.g.*, delinquent returns or to start or stop an installment agreement). The intent is, primarily, to stop the practice of solely dropping off returns when they can be mailed directly to the IRS processing campus. TACs will accept returns with imminent statute implications, with remittances or other situations where it's in the best interest of the taxpayer and the IRS to accept them.

35 IRM 21.3.4.7.11.5 (Apr.1, 2011). To comply with the requirements associated with the segregation of duties and to implement the remittance/courier process, three separate employees are required to complete the cash transaction.

36 IRM 21.3.4.7.2 (Oct. 1, 2011).

37 *See* National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress, *Filing Season Review* 43 (June 2012).

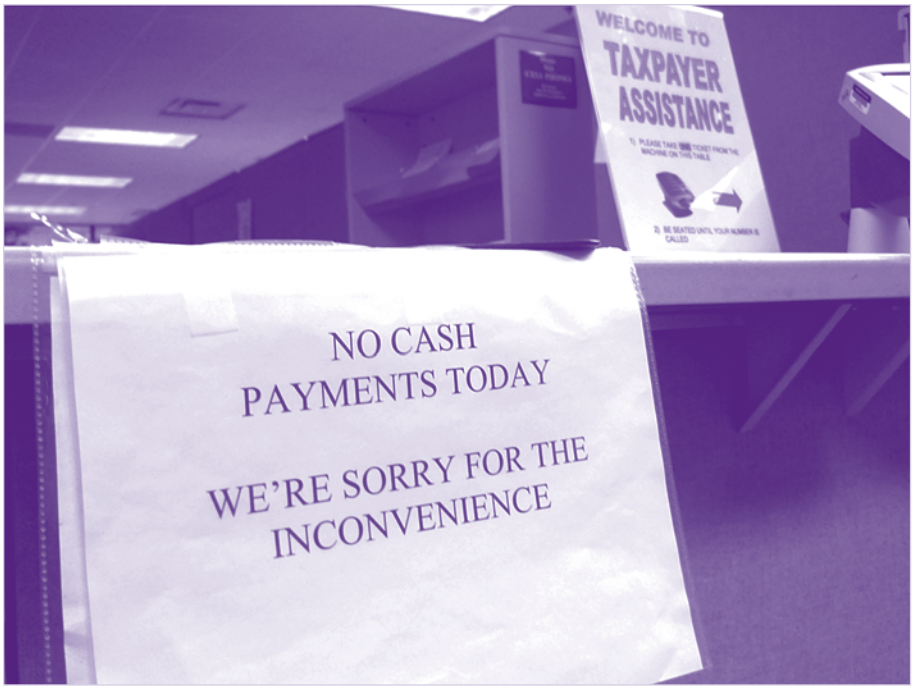


Figure 1.17.4 displays IRS Publication 4996 "Payments"

IRS Taxpayer Assistance Center

Payments
Pagos

Cash payments are not accepted in this office.

Write your name and Social Security Number (SSN), or Employer Identification Number (EIN), or Individual Taxpayer Identification Number (ITIN) on the payment document.

Make your check or money order payable to the "U.S.Treasury."

We cannot issue receipts for non-cash payments.

Los pagos con dinero en efectivo no se aceptan en esta oficina.

En el documento del pago, escriba su nombre y el Número de Seguro Social (SSN), o el Número de Identificación Patronal (EIN), o el Número de Identificación de Contribuyente Individual (ITIN).

Haga su cheque o giro pagadero a "U. S. Treasury."

No podemos emitir recibos para los pagos que no sean en efectivo.

To make a payment online go to www.irs.gov and select Filing & Payment
Para hacer un pago en Internet vaya a **www.irs.gov** y seleccione **Filing & Payment**

Publication 4996 (EN/SP) (3-2012) Catalog Number 59430F Department of the Treasury Internal Revenue Service www.irs.gov

The IRS Uses Multiple Channels to Meet Face-to-Face Taxpayer Service Needs Beyond TACs.

The IRS is taking steps to maintain or expand services in some of its locations, including Facilitated Self-Assistance (FSA). FSA uses self-service kiosks, currently located in 37 TACs throughout the country, where the IRS provides help with self-assistance (on computer workstations).[38] FSAs allow the IRS to educate taxpayers on different services channels. Taxpayers can access Free File, print tax forms and publications, and perform research.[39] However, IRS employees must be on hand to assist taxpayers using FSA and to determine if they can resolve their issues this way. While FSA may allow taxpayers with simpler issues to avoid TAC lines, and free TAC employees to work more complex issues, it does not alleviate the need to provide IRS employees as guides to FSA.

The IRS has also piloted virtual face-to-face (VFTF) services in an effort to reach more taxpayers. Using video communication technology, taxpayers can have virtual face-to-face interactions with assistors in remote locations.[40] Once the taxpayer steps up to the monitor and provides identification, the IRS employee can provide many services normally handled in a TAC. The FY 2012 VFTF service delivery pilot, which included 12 locations, allowed the IRS to maximize its resources, by expanding hours of service in remote locations and balancing the workload in high-traffic areas.[41]

Through May 26, 2012, the IRS served more than 12,500 walk-in taxpayers through VFTF, assisting with account and tax law inquiries.[42] Additionally, both TAS and the Office of Appeals tested VFTF during the pilot period, with TAS offering taxpayers the opportunity to interact face-to-face with case advocates and Appeals using video technology to connect Appeals Officers with two Low Income Taxpayer Clinics. Plans to expand VFTF in fiscal year 2013 include services from W&I, pilot services from the Small Business/Self-Employed (SB/SE) division, and more locations for TAS and Appeals.[43] Another possible expanded use of this technology would place VFTF terminals in Volunteer Income Tax Assistance (VITA) sites during the filing season so IRS employees can address account-related questions that VITA staff cannot answer.[44]

While the National Taxpayer Advocate wholeheartedly supports these promising efforts, the IRS can do a better job of matching its resources and services with taxpayer demand.

38 W&I Field Assistance (TAP) PowerPoint Presentation, Who We Are, 10 (June 2012).

39 http://www.irs.gov/pub/irs-soi/10rpresconfacilitate.pdf Facilitated self-service kiosks are located in 37 TACs throughout the country.

40 For an in-depth discussion of virtual face-to-face services, see Status Update: *The IRS has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance, infra*.

41 The Virtual Face-to-Face pilot included ten TACs and two Stakeholder Partnership Education and Communication (SPEC) partner organization sites. IRS W&I Division Field Assistance (Taxpayer Advocacy Panel) PowerPoint Presentation, Who We Are, 13 (June 2012).

42 W&I Business Performance Review, 3rd Quarter 4 (Aug. 15, 2012).

43 *Id*.

44 *See* Status Update: *The IRS has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance, infra/supra*. The VITA program, administered by the IRS, originated with the Tax Reform Act of 1969 as part of the increased emphasis on taxpayer education. VITA provides underserved communities with free tax filing assistance, using IRS-certified volunteers.

For example, the IRS has placed FSA kiosks in only 37 of the 397 TACs, so only a small percentage of taxpayers can use them. As noted above, many taxpayers are uncomfortable using such technology for tax matters even when they have access to it. The IRS can accomplish its taxpayer service goals by balancing technology – FSA and VFTF — with traditional face-to-face interactions in the TACs and by expanding access to all services.

CONCLUSION

Advances in technology do not eliminate the need for taxpayers to meet with IRS employees in person to discuss notice inquiries, concerns about refunds, tax law questions, options for payment agreements, and more. The National Taxpayer Advocate applauds the IRS's effort to use technology to communicate with certain segments of the taxpayer population. However, for certain taxpayers, technology will never replace face-to-face communication.[45] As the IRS moves forward with VFTF service and explores offering additional Internet services, it must understand how different taxpayer populations are able to interact with the IRS. Without sufficient data, the IRS cannot hope to address the needs and preferences of varying segments of taxpayers. A rigorous and regularly updated analysis of how taxpayers use IRS services, how they prefer to use IRS services, and their willingness to use new IRS services would allow the IRS to precisely allocate service resources across different channels. And evaluating the impact of changes and reductions to face-to-face TAC services will prevent the IRS from harming and abandoning taxpayers, especially the most vulnerable populations.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Continue to study taxpayer needs and preferences and work with TAS to update the surveys done in coordination with the 2006 Taxpayer Assistance Blueprint by addressing service delivery options through traditional channels and emerging technologies.
2. Commit to using the W&I and TAS ranking tool in making changes in taxpayer service policies and offerings, including the three taxpayer value criteria proposed by TAS; to completing the research necessary to fully populate the tool's data fields; and to extending the methodology to enable scoring of changes to the way covered services are delivered (*e.g.,* increases or decreases in the level of service or available service hours for a service activity).
3. Partner with TAS to study and rigorously analyze the downstream consequences of changes in taxpayer service policy and their impact on different taxpayer groups.
4. Reinstate the policy of allowing taxpayers to make appointments at TACs for tax return preparation during filing season and throughout the year.

[45] *See* IRS's Annual Report to Congress, *Progress on the Implementation of The Taxpayer Assistance Blueprint* 8 (Mar. 14, 2012). While a significant majority of taxpayers would use online resources to complete transactional tasks, a significant minority are not willing or able to use web-based self-service tools.

IRS COMMENTS

Delivering excellent customer service is a priority of the IRS. The Taxpayer Assistance Centers are one of the vital resources available to taxpayers. TAC assistors provide a variety of services to taxpayers who visit the 397 TAC[46] locations throughout the country. The TAC program provides face-to-face assistance to taxpayers who cannot resolve their problem over the telephone or through correspondence, need a document issued to them in a reasonable period of time, or prefer face-to-face contact. In FY 2012, this type of live assistance was provided to seven million taxpayers.

Recognizing resource limitations and competing priorities, the IRS takes steps to monitor performance and provide the most effective service possible within its allocated budget. The IRS is committed to providing superior customer service, attempts to offer the best mix of services for all taxpayers, and concentrates on those that only the IRS provides. We conduct customer satisfaction surveys related to our services and offerings and other initiatives that capture customer and stakeholder concerns and complaints. Additionally, we track diagnostic measures that assess our ability to provide customer service in a timely manner. Our customer satisfaction surveys reflect favorably on our service offerings. The IRS also monitors wait times and triage taxpayers waiting for service. This allows us to assist more taxpayers with less complex issues quickly while allowing more experienced assistors to focus on helping those taxpayers with complex issues.

To improve taxpayer service, the IRS is adding Facilitated Self-Assistance to many TAC locations and piloting Virtual Service Delivery. The expansion to self-help options allows IRS to provide quick and accurate answers to many taxpayers and can free up our live customer service resources to address taxpayer inquiries that require personal interaction.

During FY 2012, the IRS completed the VSD pilot in the TACs, and it was deemed successful, serving almost 17,000 taxpayers through the end of September. The report showed that the vast majority (87 percent) of taxpayers using VSD reported that they received resolution for their main issue. An even larger number of respondents (91 percent) reported that they would be willing to use video assistance again during a future visit. The IRS will be expanding the VSD program in FY 2013. Planning is underway to deploy virtual service in six TACs and six partner sites for the 2013 filing season.[47]

The IRS took a comprehensive look at TACs and determined there was a need to modify some of its services beginning in FY 2012. While we added services such as VSD, the IRS must constantly monitor the menu of existing services offered. In FY 2012, IRS began offering year round return preparation two to three days per week, determined by staffing and workload for each TAC. Appointments are available when a taxpayer has special needs, such as those with disabilities. Appointments may also be provided at local

46 IRS, *Contact Your Local IRS Office, available at* http://www.irs.gov/uac/Contact-Your-Local-IRS-Office-1.

47 IRS, W&I Business Performance Review, 4th Quarter (Nov. 14, 2012).

management's discretion but generally, return preparation is offered on a first-come, first-serve basis. Scheduling appointments for return preparation reduces resources available to provide services to taxpayers who are awaiting other more complex services.

When TAC assistors are unavailable to prepare returns during the days offered, taxpayers are educated and offered several free filing options. These options include directing taxpayers to a local IRS-sponsored Volunteer Income Tax Assistance sites or Tax Counseling for the Elderly sites and to other available free electronic filing options (IRS Free File and IRS Free Fillable Forms) that could possibly reduce their time waiting for return preparation services in TACs. Many VITA and TCE sites receive grants from the IRS to prepare returns with the low-income, elderly, disabled, and those that speak limited English, with some open year-round. Last year, VITA and TCE volunteers prepared returns with a 92 percent rate of accuracy.[48] External partners share data with the IRS concerning the availability of their VITA and TCE sites during and after the filing season. This ensures that site information such as locations and hours of operation are timely updated on the IRS.gov VITA Site Locator. Providing these alternatives is beneficial for taxpayers in that they are educated as to the various free options available for return preparation service.

Although we strive to assist all taxpayers, some taxpayers enter TACs with questions and concerns that are out of scope for TAC employees. When this situation arises, the TAC employees provide three options to the taxpayer to assist in resolving the issue:

- The taxpayer will be escorted to a vacant workstation and the TAC employee contacts the appropriate function via telephone for assistance.
- The TAC employee will encourage the taxpayer to call the appropriate toll-free number or check IRS.gov from the comfort of their home.
- Employees will also provide Publication 4604 (EN/SP), *Use the Web for IRS Tax Products & Information*, to educate taxpayers on other automated options for ordering and printing forms and publications. When requested, these documents can be printed locally.

As mentioned in the Most Serious Problem, the National Taxpayer Advocate and the Commissioner of Wage and Investment initiated a joint team to develop a method of evaluating the impact of a reduction or elimination of any service to taxpayers. The Service Priority Project was established to quantify the value of service tasks by service channel (*i.e.,* face-to-face, assisted and automated telephone, and online), based on government and taxpayer value criteria. The service tasks are defined at a broad level, *e.g.,* providing general tax law assistance and information and providing tax account assistance.

48 Stakeholder Partnerships, Education & Communication Total Relationship Management System (SPECTRUM), Report # 2012F67229R, *Accuracy Percentage by 8 Percent Primary Questions Report*, April 20, 2012.

The project team discussed numerous criteria to capture government and taxpayer value. Relevant criteria were suggested in TAB Phase 2.[49] The set of government and taxpayer value criteria that would be included in the first model were limited by the availability of data.

The ranking tool is still under development. Once operational, the IRS will use the ranking tool as a guide, along with other relevant information, in making decisions about changes to taxpayer services. The IRS will incorporate the three criteria proposed by TAS into the ranking tool as data become available. The IRS will modify existing surveys in order to collect data that will populate the data gaps in the current model. These modifications will be constrained by budget considerations. For example, an increased sample size necessary to collect the detailed data for the model will increase the survey cost. While the ranking tool is under development, the project team has proposed that information available about the relevant criteria be included as addenda to the IRS's score sheets. Preliminary scores of the draft ranking tool were used to assess the proposed 2013 taxpayer service changes, and the scores supported the proposed changes. The ranking tool is not designed to provide information about the impact of specific changes in service attributes (*e.g.,* hours of operation, wait time, etc.).

The IRS will evaluate the cost-effectiveness of conducting research that will provide the detailed data needed to quantify changes in service attributes (*e.g.,* level of service, hours of operation). The IRS conducts strategic research on an ongoing basis, such as the TAC Expectations Survey, to get a measure of the face-to-face customer base and needs. Our research has indicated, however, that is difficult to measure the downstream consequences of particular service changes and their impact on different taxpayer groups.

Finally, the IRS welcomes continued partnership with the Taxpayer Advocacy Panel in addressing taxpayer needs and preferences. During 2010, the IRS conducted the Customer Expectation Survey in part, to address the concerns of the TAP and the Treasury Inspector General for Tax Administration (TIGTA).[50] The IRS is planning to conduct a similar survey in FY 2013 to keep up with emerging taxpayer needs and to match them with the limited resources available. The IRS has also enhanced the Field Assistance Customer Survey Card for 2013 to include questions regarding alternative service channels.[51]

49 IRS, *2007 Taxpayer Assistance Blueprint, Phase 2* 123 (Apr. 2007).

50 IRS, *Taxpayer Assistance Center Customer Expectation Final Report*.

51 IRS Form 13359, *Your Opinion Counts!* (Sept. 2012).

Taxpayer Advocate Service Comments

Providing quality taxpayer service to address the needs of a large and varied taxpayer population is crucial to the IRS mission. The National Taxpayer Advocate is pleased that the IRS recognizes the value of offering many service channels to address taxpayer needs. In particular, TAS fully supports the expansion of the VFTF service delivery channel.[52] Additionally, she is pleased that the IRS has agreed to incorporate the TAS criteria in the jointly developed service ranking tool and will use this tool to make future taxpayer service decisions.

However, the National Taxpayer Advocate is surprised to learn that the IRS used this ranking tool "to assess the proposed 2013 taxpayer service changes" and that "the scores supported the proposed changes." W&I senior leadership did not discuss this ranking with the National Taxpayer Advocate, nor does it appear that W&I included TAS's executive team's "votes" in that ranking. Moreover, as noted above, W&I declined to include this ranking on the agenda for its pre-filing season Services Committee meeting, which includes the IRS Senior Leadership and is the most appropriate for a discussion of taxpayer service changes that affect *all* taxpayers. Thus, the IRS justifies its dilution of TAC services for FY 2013 by its own self-serving ranking, without incorporating the viewpoint of the National Taxpayer Advocate — the statutory voice of the taxpayer within the IRS — or any other IRS senior official in the ranking. Going forward, W&I must do better. Otherwise, this ranking tool is a farce.

The IRS must remain cognizant of the taxpayer perspective as it makes service delivery decisions. Failing to fully populate the ranking tool data before making taxpayer service strategy changes will cause the IRS to continue making decisions in a vacuum. Instead, it must commit to recognizing the importance of the taxpayer experience with IRS services and use internal data and external research to fully understand the downstream impact and consequences of taxpayer service changes. It should be a budget priority of the IRS to complete the research and data collection necessary to make the ranking tool effective. While populating the tool will require an investment upfront, it will, in the long term, allow the IRS to make better decisions and target resources more appropriately. It will also enable the IRS to inform Congress of the compliance and other impacts of insufficient funding for taxpayer service, including which service cuts will harm the most vulnerable populations. Without this information, the IRS is making resource allocation decisions in the dark.

The National Taxpayer Advocate remains concerned about the decision to no longer offer appointments for tax return preparation in the TACs and the impact on taxpayers. Although other free or low cost alternatives exist for return preparation, turning taxpayers away and directing them to spend additional time seeking out other return preparation options after already visiting a TAC adds to taxpayer burden. The policy change may have

52 For an in-depth discussion of VFTF services, see Status Update: *The IRS has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance*, *infra*.

been responsible for the over 50 percent decline in returns prepared in the TACs in filing season 2012.[53] The IRS did not track if these taxpayers actually followed through on the suggestion to have returns prepared by VITA or TCE, if they qualified.

Finally, while self-assist options for taxpayers are an important component of a well-rounded taxpayer service strategy, the IRS cannot rely solely on these options to fulfill service gaps. The TAP survey demonstrated that many taxpayers attempted to use these channels, were unable to resolve their issues, and ended up seeking face-to-face assistance at a TAC.[54] Additionally, the IRS knows that certain taxpayer segments are unable or unwilling to use self-assistance options and it must meet the needs of those taxpayers through other channels.[55]

Recommendations

The National Taxpayer Advocate recommends the IRS take the following actions:

1. Continue to study taxpayer needs and preferences and work with TAS to update the surveys done in coordination with the 2006 Taxpayer Assistance Blueprint by addressing service delivery options through traditional channels and emerging technologies.
2. Commit to using the W&I and TAS ranking tool in making changes in taxpayer service policies and offerings, including the three taxpayer value criteria proposed by TAS; to completing the research necessary to fully populate the tool's data fields; to extending the methodology to enable scoring of changes to the way covered services are delivered (*e.g.,* increases or decreases in the level of service or available service hours for a service activity); and to including a broad array of TAS and IRS senior leadership in the actual ranking of service offerings and to timely discussing this ranking at the IRS Services Committee.
3. Partner with TAS to study and rigorously analyze the downstream consequences of changes in taxpayer service policy and their impact on different taxpayer groups.
4. Reinstate the policy of allowing taxpayers to make appointments at TACs for tax return preparation during filing season and throughout the year.

53 IRS, *Field Assistance E-File Report*, April 2012. In filing season 2011 (through Apr 4, 2011) 113,387 returns were e-filed in the TACs compared to just 55,958 (through Apr. 2) in filing season 2012, a 50.6 percent decline. For a further discussion of the National Taxpayer Advocate's concerns about return filing, see Most Serious Problem: *The IRS has Failed to Make Free Return Preparation and Free Electronic Filing Available to All Individual Taxpayers*, *infra*.

54 This survey effort was supported by the National Taxpayer Advocate and her Research and Systemic Advocacy staffs. TAP volunteers returned 664 completed surveys from 33 different TAC offices. While these results are not statistically representative of all TAC visitors, they represent the needs and activities of a sizable number of TAC customers during one week in the tax filing season. Percentages shown are out of all 664 respondents. Some respondents did not answer every question. Twenty-five percent of survey respondents attempted to call the IRS before visiting a TAC and 34 percent attempted to find an answer on IRS.gov.

55 See W&I Taxpayer Experience Survey, Tax Year 2009, Filing Season 2010, 24 (May 2011); *see also* IRS, 2007 Taxpayer Assistance Blueprint Phase II, 111.

MSP #18

The IRS is Substantially Reducing Both the Amount and Scope of Its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of Its Remaining Outreach Activities, Thereby Risking Increased Noncompliance

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Faris Fink, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

Despite the IRS's longstanding belief that taxpayer education is essential to voluntary compliance, and the significant resources it dedicated to outreach and education in the immediate aftermath of the IRS Restructuring and Reform Act of 1998 (RRA 98), the IRS has retreated from its earlier commitments.[1] As a consequence:

- Wage and Investment (W&I), the operating division with responsibility for helping 123 million individual taxpayers understand and comply with their tax obligations, now devotes only about six percent of its outreach and education budget to activities that involve direct, face-to-face, contact with taxpayers;
- W&I will not offer any outreach that is not directly related to return filing unless another IRS unit agrees to provide the funding;
- Small Business/Self Employed (SB/SE), the division serving the needs of 57 million business taxpayers, has no outreach and education employees in 12 states;
- SB/SE plans to further reduce its face-to-face outreach and education to tax practitioners in the coming fiscal year; and
- Less than a third of SB/SE's outreach events were targeted directly to small business owners.[2]

Despite the growing complexity of tax laws and tax procedures, W&I and SB/SE outreach and education programs now have a local presence in fewer communities than when they were conceived over ten years ago, and the IRS's most recent cost-cutting measures have been directed disproportionately at employees of those programs. In fiscal year (FY) 2011, residents of almost half of the U.S. did not have an opportunity to hear from a W&I outreach employee providing information about the Earned Income Tax Credit (EITC) in their states.[3]

1 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 (1998) § 1001.

2 SB/SE Calendar of Events, *available at* http://sbse.web.irs.gov/cl2/sl/Events_Calendar/default.asp; IRS response to Most Serious Problem (Nov. 2, 2012).

3 IRS response to TAS information request (July 30, 2012).

The IRS has never ascertained whether its focus on filing compliance and its leveraged approach to outreach and education promote taxpayer compliance, reduce taxpayer noncompliance, or compensate for the reduction in pre-filing services and the elimination of the direct contact local employees once had with taxpayers. Nevertheless, it has replaced the previous model — in which local outreach and education employees, as well as Revenue Officers, Revenue Agents, and managers, were expected to respond to taxpayers' needs — with a system in which outreach and education are available only with respect to a few issues the IRS selects, delivered in the manner it selects, unless another part of the government pays for it.

ANALYSIS OF PROBLEM

Background

Prior to 1998, the IRS was organized into 43 geographically defined districts and service centers.[4] District Directors adopted Taxpayer Education (TPE) programs, which were managed by the Examination or Collection functions within their districts.[5] The IRS encouraged its staff to

> accept invitations to deliver speeches, participate in tax forums, conferences, seminars and meetings, write articles for publications and have similar contact with outside groups. Such activities are an effective way to inform and educate the public about the Service's mission and operations and to help taxpayers understand their rights and obligations.[6]

District Directors were advised, "Your personal participation can go a long way in strengthening volunteer involvement in Taxpayer Education and in making the public aware of the educational and informational assistance available."[7]

As a result of RRA 98, the IRS reorganized into four taxpayer service units, each responsible for serving groups of taxpayers with similar needs, and abandoned geographical location as its organizational principle.[8] Stakeholder Partnerships, Education and Communication (SPEC), an amalgam of TPE and other existing field functions, "stood up" as a new W&I organization in October of 2000.[9] Similarly, the Taxpayer Education and Communication office (TEC) was formed as a new program within SB/SE when that division stood up. While SPEC and TEC had the objective of collaborating with local

4 S. Comm. on Finance, *Hearings on IRS Restructuring*, 105th Cong. S. Hrg. 105-529, Jan. 28, 1998, 20 (testimony of Hon. Charles O. Rossotti, Commissioner of Internal Revenue).

5 SPEC CONOPS 4 (2001), *available at* http://win.web.irs.gov/spec/docs/spec_conops.pdf; IRM 22.30.1.1.2 (Jan. 1, 2002).

6 IRM 1.2.191.8(2), Policy Statement 1-181 (July 24, 1989).

7 IRM 6570, Exhibit 400-5 (May 12, 1988).

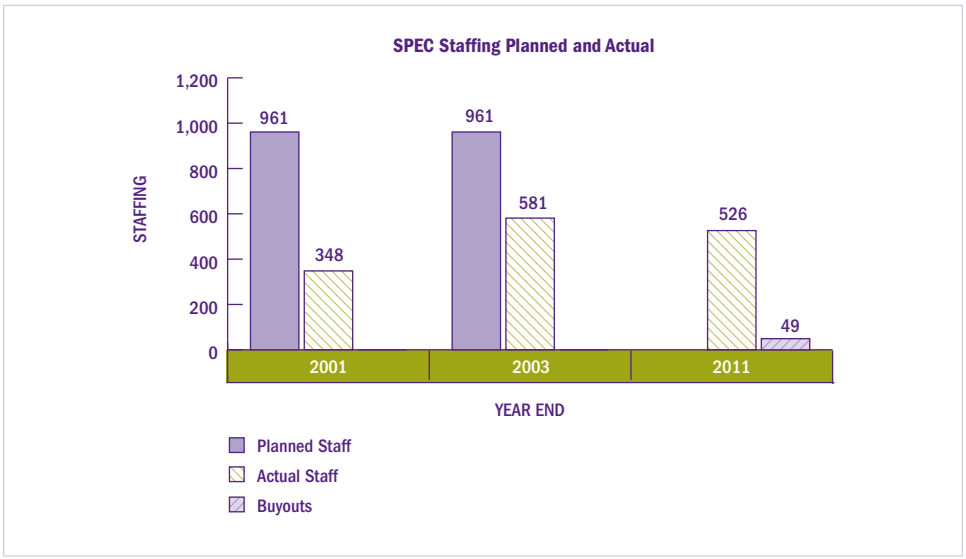
8 RRA 98, Pub. L. No. 105-206 (1998) § 1001.

9 SPEC CONOPS 4 (2001), *available at* http://win.web.irs.gov/spec/docs/spec_conops.pdf; IRM 22.30.1.1.2 (Jan. 1, 2002).

organizations to deliver outreach and education (*i.e.*, leveraging their activities), the vision of local IRS employees interacting with taxpayers continued.[10]

In the immediate aftermath of RRA 98, the IRS dedicated significant resources to its new education and outreach organizations, and planned to dedicate even more, thereby meeting taxpayers where they were.[11] SPEC staffing peaked in 2003, however, at about 60 percent of the planned level, as shown by Figure 1.18.1, below.

FIGURE 1.18.1, Spec Planned and Actual Staffing[12]



In November of 2011, when W&I offered buyouts or early retirement to about six percent of all its employees, it extended the offer to 58 percent of SPEC employees.[13]

10 IRM 21.10.4.8.2.4 (Dec. 1, 2000) provided: "Community Outreach Tax Education is conducted by IRS employees and qualified volunteers. IRS employee instructor sources include Taxpayer Service Representatives, Taxpayer Service Specialists, Customer Service Representatives, Revenue Agents, Tax Auditors, and Revenue Officers. ...It may be necessary to offer overtime or compensatory time to employees in order to provide adequate staffing at Outreach sessions."

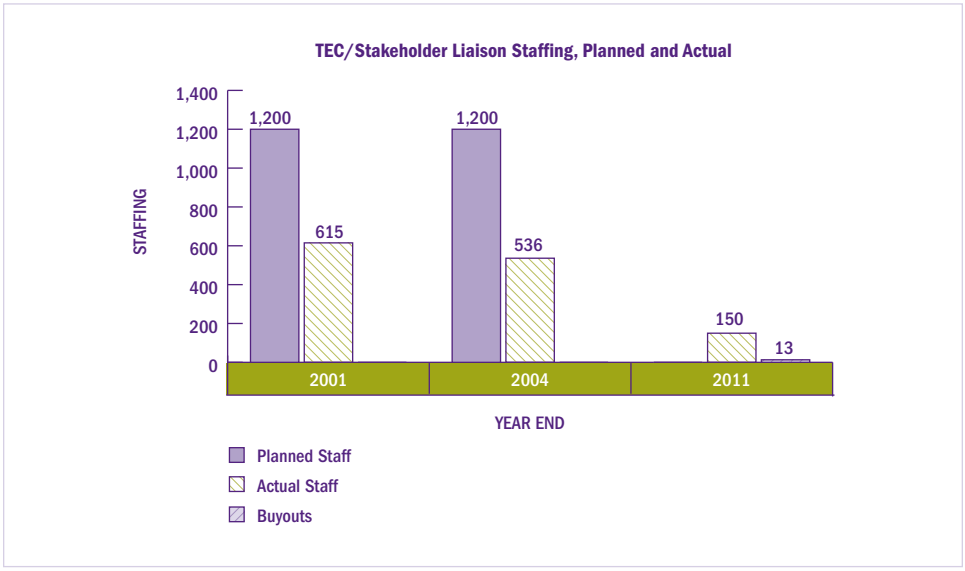
11 SPEC was intended to have 961 employees distributed among 48 territories and 72 field offices. IRS Organization Blueprint 2000, Fig. 2-1, W&I Division Organization Structure, Fig. 2-3, Communications, Assistance, Research and Education (CARE) Organization Structure. TEC was intended to have 1,200 employees distributed among 84 domestic territories, two international territories and 219 posts of duty. Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2000-30-149, *Management Advisory Report: The Small Business/Self Employed Division Will Substantially Stand Up on October 1, 2000* 8 (Sept. 2000) Fig. 3-3, Taxpayer Education Communication Organization Structure (2000).

12 W&I CARE, Discussion Document, *Stand-Up and Beyond* Appendix A, 1 (Jan. 2001); AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section, *available at* https://persinfo.web.irs.gov/track/workorg.asp.

13 IRS responses to TAS information request (July 19 and Aug. 2, 2012); IRS response to Most Serious Problem (Nov. 2, 2012). W&I offered buyouts or early retirements to 1,535 out of a total of about 25,000 fulltime W&I employees on roll for the last pay period of 2011, for a rate of about six percent. W&I offered buyouts or early retirements to 332 of a total of about 577 SPEC employees on roll for the relevant pay period of 2011, for a rate of 58 percent. AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section *available at* https://persinfo.web.irs.gov/track/workorg.asp. Actual attrition was about eight percent, as 49 SPEC employees accepted the offers.

In 2005, SB/SE merged TEC into other outreach and communication units within the division, ultimately replacing it with today's Stakeholder Liaison (SL) unit with drastically reduced staffing, as shown by Figure 1.18.2 below. The realignment left twelve states without a Stakeholder Liaison employee. Again today, twelve states do not have a Stakeholder Liaison employee within their borders.[14]

FIGURE 1.18.2, TEC and Stakeholder Liaison Planned and Actual Staffing[15]



SB/SE offered buyouts or early retirement to about eight percent of all of its employees, but extended the offer to 69 percent of Stakeholder Liaison field employees.[16]

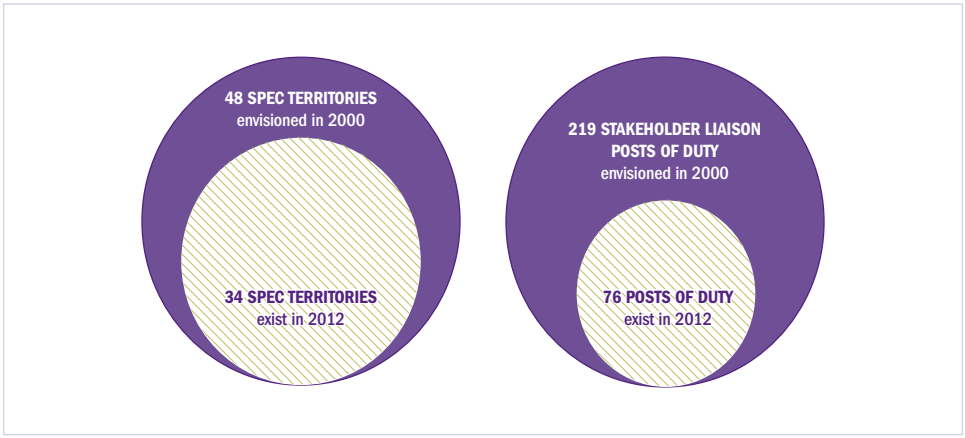
The IRS's outreach personnel today do not meet taxpayers where they are. Figure 1.18.3. shows how employees of both organizations were intended to be dispersed over geographic areas compared to how they are dispersed today:

14 IRS response to TAS information request (July 19, 2012). The states without a local stakeholder liaison are Alaska, Delaware, Hawaii, Indiana, Mississippi, Montana, Nebraska, New Hampshire, North Dakota, Vermont, West Virginia, and Wyoming.

15 TIGTA, Ref. No. 2000-30-149, *Management Advisory Report: The Small Business/Self Employed Division Will Substantially Stand Up on October 1, 2000* 8 (Sept. 2000); AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section, *available at* https://persinfo.web.irs.gov/track/workorg.asp.

16 IRS response to TAS information request (July 19, 2012); IRS response to Most Serious Problem (Nov. 2, 2012). SB/SE offered buyouts or early retirements to 1,967 out of a total of about 24,000 SB/SE employees on roll for the last pay period of 2011, for a rate of about eight percent. SB/SE offered buyouts or early retirements to 116 out of a total of about 168 Stakeholder Liaison field employees on roll for the affected pay period of 2011, for a rate of 69 percent. AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section *available at* https://persinfo.web.irs.gov/track/workorg.asp. Actual attrition was about 11 percent, as 13 Stakeholder Liaison field employees accepted the offers.

FIGURE 1.18.3, SPEC and Stakeholder Liaison Geographic Dispersion[17]



In addition to reductions in outreach and education staff, there is no IRM provision corresponding to the one that urged District Directors to engage in face-to-face outreach. In terms of IRS guidance to employees, outreach and education are now "siloed" in SPEC and Stakeholder Liaison, rather than treated as the responsibility of IRS employees from senior leaders to front-line employees.

SPEC Now Focuses on Return Preparation.

SPEC administers the IRS's Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs that provide free return preparation for low to moderate income and elderly taxpayers, respectively.[18] In light of its reduced staff, SPEC shifted its resources from outreach and education to these programs, allocating six percent of its direct labor hours to pre-filing outreach and 74 percent to supporting return preparation in FY 2011.[19] SPEC outreach is now limited to topics related to return filing, such as EITC, efile, Free File, and direct-deposit methods for refunds. For any other topic, SPEC employees will provide direct taxpayer outreach or develop new partners only if the IRS business unit or function requesting the outreach also funds it.[20]

Almost all of SPEC outreach is leveraged (*i.e.*, delivered by its partners). From October 2011, through June 2012, SPEC employees conducted 158 outreach events, compared to 2,404 events conducted by partners.[21] EITC outreach events featuring SPEC speakers or presenters took place in 36 cities in 29 states in FY 2011, meaning that residents of 21

17 IRS Organization Blueprint 2000, Fig. 2-3, CARE Organization Structure and Fig. 3-3, Taxpayer Education Communication Organization Structure (2000).

18 For a more complete discussion of those programs, see Most Serious Problem: *The IRS Has Failed to Make Free Return Preparation and Free Electronic Filing Available to All Individual Taxpayers, infra*.

19 IRS response to TAS information request (July 30, 2012). In fiscal year (FY) 2011, SPEC charged 1,278,877 labor hours, of which 620,069 were direct hours. Return preparation consumed 460,184 direct hours, or 74 percent of total direct hours, and outreach consumed 38,709 direct hours, or six percent of total direct hours.

20 W&I response to TAS information request (July 19, 2012).

21 IRS response to Most Serious Problem (Nov. 2, 2012).

states never had the opportunity to see a SPEC employee at an EITC outreach event in their state.[22] For these taxpayers, the RRA 98 vision of local IRS employees providing outreach and education directly to them, based on their local characteristics, has been lost.

SB/SE Expected Efficiency Gains from an Increased Emphasis on Leveraging but Has Not Gathered Sufficient Information to Ensure that it Leverages Effectively.

Following the 2005 TEC realignment, Stakeholder Liaison increased its reliance on leveraging, focusing its outreach on practitioner and professional organizations with the hope that the information passed on to them would trickle down to actual taxpayers.[23] Of the more than 3,500 Stakeholder Liaison outreach events in FY 2011, 1,165 (less than a third) were Leveraged Small Business Tax Workshops, the only outreach that targets small business owners directly.[24] The National Taxpayer Advocate has had misgivings about this trickle-down approach since its beginning, and in 2006 pointed out that Stakeholder Liaison had no five-year strategic plan and still did not measure the effectiveness of its outreach efforts. Some SB/SE research suggested that face-to-face outreach was more effective in increasing compliance than more passive alternatives.[25] However, SB/SE could not tailor its outreach to specific groups of taxpayers because it did not have information about the characteristics and needs of small business and self-employed taxpayers.[26]

SB/SE responded to the National Taxpayer Advocate's concerns by describing its outreach initiatives directed to taxpayers with limited English proficiency (LEP). Stakeholder Liaison had launched Hispanic Small Business Forums in states where this target audience was likely to be found, such as California, Florida, New York, South Carolina, and New Jersey, and planned to expand this outreach nationwide.[27] According to Stakeholder Liaison outreach and education records for 2011, however, there were only seven Hispanic Small Business Forums, and only three of them were in a state SB/SE had identified as likely to

22 W&I response to TAS information request (July 19, 2012). In the same period, SPEC employees visited return preparation sites in every state for a total of more than 4,400 times.

23 National Taxpayer Advocate 2006 Annual Report to Congress 173 (Most Serious Problem: *Small Business Outreach*).

24 Data on Stakeholder Liaison events is recorded and stored on the CSO Calendar of Events, a searchable database with information about outreach events, *available at* http://sbse.web.irs.gov/cl2/sl/Events_Calendar/default.asp. The calendar contains information about 3,644 events from Oct. 1, 2010, to Sept. 30, 2011. In Leveraged Small Business Tax Workshops, the IRS "support[s] partner and stakeholder efforts by providing them with educational materials and serving as a resource. Partners use the IRS materials to educate small business and industry stakeholders." IRM 11.53.5.14.5(2) (Nov. 25, 2009). There were 1,054 such workshops in FY 2011, and an additional 111 shown as "Spanish/Other." There were no such workshops in FY 2011 in four states: Delaware, Mississippi, West Virginia, and Wyoming. In FY 2010, there were 1,109 workshops, held in all 50 states.

25 National Taxpayer Advocate 2006 Annual Report to Congress 172, 186-87 (Most Serious Problem: *Small Business Outreach*). IRS response to Most Serious Problem (Nov. 2, 2012).

26 National Taxpayer Advocate 2006 Annual Report to Congress *Most Serious Problem: Small Business Outreach* 172, 181-182. In 2010, TIGTA identified the same problem of SB/SE's lack of information about taxpayer needs. TIGTA, Ref. No. 2011-40-010, *Multiple Channels Are Used to Provide Information to Small Business Taxpayers, but More Information is Needed to Understand Their Needs* (Dec. 2010).

27 *Id*. at 172,191. A Small Business Forum (SBF) is "an open forum with Industry stakeholders that allows parties to exchange ideas, gather information about emerging stakeholder issues, manage relationships, and maintain a dialogue with stakeholder groups... The forum is a co-sponsored event, where SL [Stakeholder Liaison] leverages the influence of lead partners to draw other stakeholders to the event." IRM 11.535.14.3 (Nov. 25, 2009).

have the target audience, that state being New Jersey.[28] Stakeholder Liaison's 2011 outreach also included 57 Leveraged Small Business Tax Workshops designated "(Spanish/Other)" for LEP taxpayers.[29] More than 30 of the workshops were held in New York or California, one was held in New Jersey, and none were held in the other states identified as having the greatest concentration of this target audience.[30] In this instance, the IRS has identified a taxpayer need but does not meet it.

As for outreach to practitioners, the National Taxpayer Advocate in 2006 noted:

> Even if SB/SE attempts to provide outreach to practitioners in these states [without a stakeholder liaison] on a regional or even a "traveling" basis, without establishing a permanent, continuing relationship with these stakeholders, practitioners may not know when the substitute outreach events are being held. These practitioners will also be less likely to turn to Stakeholder Liaison when specific issues come up because the practitioners will not know who to contact or may not feel a local connection with the IRS liaison. This arrangement may set the Stakeholder Liaison up for failure, or at best, limit its effectiveness.[31]

For these reasons, the National Taxpayer Advocate is concerned about SB/SE's current plans to reduce its face-to-face meetings with tax practitioners in favor of phone forums and other indirect or virtual delivery methods.[32] The shift in strategy is motivated by the desire to employ resources more efficiently. SB/SE believes that a more technology-based approach will allow it to reach more practitioners while saving the cost of having its employees travel to face-to-face venues. The decision is not supported by data showing expected savings or expected increases in the effectiveness of the outreach, and SB/SE is aware that some practitioners, as well as Stakeholder Liaison employees, prefer face-to-face meetings.[33] Nevertheless, SB/SE intends to limit in-person meetings mainly to large organizations, and may ultimately replace even these live events with virtual ones. Moreover, this virtual education and outreach will not necessarily be delivered by local employees (*e.g.*, an employee in California may address practitioners in New York), further weakening any local connection that might otherwise exist. Whatever the (unproven) benefits of this new approach may be, it will negatively affect small practitioners, many of whom cannot afford the dues

28 Three Hispanic Small Business Forums were held in Illinois and one was in Texas. SB/SE Calendar of Events, *available at* http://sbse.web.irs.gov/cl2/sl/Events_Calendar/default.asp. The Calendar of Events has a field that indicates whether events were directed to limited English proficiency taxpayers, but only three of these events were so designated.

29 An additional 18 Leveraged Small Business Tax Workshops (without the "(Spanish/Other)" designation) for LEP taxpayers were recorded in 2011, six of which were in New York and one in California, with none in the other states identified as having this target audience. Two of the New York presentations were directed to Chinese speakers and the one in California was directed to Thai speakers.

30 The remaining were held among 11 different states. SB/SE Calendar of Events, *available at* http://sbse.web.irs.gov/cl2/sl/Events_Calendar/default.asp. There were no Leveraged Small Business Tax Workshops in FY 2011, in English or Spanish, in nine states: Alaska, Arkansas, Delaware, Georgia, Idaho, Minnesota, Mississippi, West Virginia, and Wyoming. There were a total of 227 LEP events in FY 2011, representing six percent of the total number of 3,644 events with specified event dates. IRS response to Most Serious Problem (Nov. 2, 2012).

31 National Taxpayer Advocate 2006 Annual Report to Congress (Most Serious Problem: *Small Business Outreach*) 172, 184.

32 Message from Director, SB/SE Communications and Stakeholder Outreach (CSO) to all CSO employees (Aug. 15, 2012).

33 Oct. 1, 2012, conference call with CSO Director.

required to belong to large organizations and who, coincidentally, may be the ones most in need of face-to-face contact. As one practitioner describes the situation,

> [T]his is a huge concern. Tax professional groups are reporting that the IRS Stakeholder Liaison personnel are cancelling meetings and reporting that due to a limited budget they cannot meet with smaller groups. Some of these groups are quite large -100+ practitioners. Budget is understandable but many of these practitioners do not belong to professional organizations and these IRS meetings are really their only viable contact with IRS.
>
> Compliance is tough for taxpayers and without the engagement of IRS and practitioners there is a disaster brewing.[34]

The National Taxpayer Advocate is, however, encouraged by SB/SE's recent efforts to identify small business segments and determine how best to communicate with them. For example, SB/SE has identified Asian, African-American, Hispanic, baby boomer, and women entrepreneurs as market segments and investigated their characteristics and preferences. It has developed electronic welcome letters, outreach plans, and communication plans tailored to their needs and preferred delivery methods, and it is revising its calendar of events to track outreach to these segments. SB/SE is also conducting an outreach pilot in New York addressed to young entrepreneurs who are Schedule C filers, a segment it identified as underserved.[35] However, tracking information about outreach events, collecting evaluations, and maintaining data on customer satisfaction, all of which would tend to show whether an outreach activity reached its intended audience, do not show whether the outreach was effective in influencing taxpayers' behavior.

34 Email from practitioner to the National Taxpayer Advocate (Sept. 24, 2012), on file with TAS.

35 IRS response to TAS information request (July 27, 2012).

CONCLUSION

In conclusion, the National Taxpayer Advocate preliminarily recommends that SB/SE and W&I:

1. Collaborate with TAS and Compliance employees (*e.g.*, Revenue Officers and Revenue Agents) to design research initiatives to measure the effect of education and outreach methods on specific taxpayer populations or with respect to specific issues.
2. Suspend current plans to reduce in-person outreach and education to practitioners pending the outcome of such research.
3. Adjust the distribution of outreach and education staff over geographic areas in light of research findings about taxpayer characteristics in those areas.
4. Suspend the current policy of not offering outreach and education, beyond the narrow list of topics the IRS identifies, unless other government units agree to pay for it.

IRS COMMENTS

The IRS agrees with the National Taxpayer Advocate on the importance of continued customer service, outreach, and education to influence taxpayer compliance, and we share her interest in reaching individuals and small business taxpayers through these means. The IRS has not reduced the amount and scope of its education efforts. On the contrary, the IRS has worked and continues to work to increase the amount and scope of outreach to individual and small business taxpayers through the expanded use of leveraged resources and technology.

The trend in education, industry, and government is toward conducting business virtually through the use of technology. The education industry, in particular, is increasing virtual delivery with the use of webinars and other types of distance learning. The National Taxpayer Advocate, herself, has encouraged the use of new technology to provide customer service such as through online services and the use of a variety of channels to provide information to taxpayers. The IRS is implementing a business model which will increase the number of taxpayers reached by expanding technology interactions. This business model is aligned with industry trends and consistent with the National Taxpayer Advocate's interest in enhancing customer service through new technology.

The SL and SPEC functions were designed to ensure implementation of IRS strategic goals for outreach and education. The employees and leadership in these divisions have position descriptions, critical job elements, and commitments specific to outreach and education. Rather than retreating from the IRS's earlier commitment to outreach and education as suggested in the National Taxpayer Advocate's report, the IRS continues to emphasize strong, focused leadership to coordinate outreach and education activities.

In addition to the efforts of the SL and SPEC functions, outreach and education activities and responsibilities are shared and coordinated with compliance functions across the IRS

organization — and not "siloed" within these two functions. For example, while outreach to the field practitioner community is coordinated by SL, representatives from all operating divisions participate in practitioner liaison meetings. The SL function partners with the Affordable Care Act (ACA) office and the Return Preparer Office (RPO) on external presentations such as our webinar on Circular 230.

Compliance organizations work directly with their stakeholders to provide relevant and timely information through participation in conferences, meetings, and seminars around the country throughout the year. This includes:

- Presentations at the Nationwide Tax Forums attended by thousands of small business owners and tax practitioners every year;
- Partnering with key national stakeholders such as the American Payroll Association (APA), American Institute of Certified Public Accountants (AICPA), and the American Bar Association (ABA) to provide presentations at key conferences, continuing professional education (CPE) sessions, and similar meetings;
- Presentations at the National Small Business Forums and Reporting Agent Forums;
- Presentations at various state-level conferences and CPE events;
- Creation of specialized technical content available on IRS.gov and YouTube; and
- Articles in technical publications such as the SSA-IRS Reporter.

Although it is correct that staffing is below the levels initially planned after the IRS Restructuring and Reform Act of 1998 (RRA 98), staffing numbers alone do not provide an accurate portrayal of the number of individual and small business taxpayers reached by SL and SPEC and their partner organizations. When the IRS realigned to the current SL organization from the previous Taxpayer Education and Communication function, we purposefully restructured the SL business model to reach more taxpayers through leveraged outreach and reduced staffing accordingly. Our leveraged model enables SL to provide information to industry and practitioner associations in all 50 states. These groups then provide this information to their members and clients, which expands our influence far beyond the direct participation of taxpayers attending outreach events. The SL function currently has partnerships with 5,969 industry partners and 1,749 practitioner partners.

The SPEC function offers taxpayer assistance through a three-pronged business model: tax preparation, taxpayer education, and financial education and asset building. SPEC also utilizes its partner relationships to deliver outreach and education by cultivating and developing relationships with partner organizations in locations identified as having new needs. The SPEC function has partners in all 50 states, including over 3,931 local partner organizations, 396 local coalitions, and 63 National Partners. Regarding the number of SPEC events referenced in the National Taxpayer Advocate's report, these numbers do not accurately reflect all of our activities for 2011 as they only reflect Earned Income Tax Credit

outreach events for a five-month period of 2011 and do not include additional non-EITC outreach activities because that data was not tracked for FY 2011.

In her report, the National Taxpayer Advocate has expressed concern with the IRS's lack of data on how the outreach delivery method (*i.e.*, face-to-face versus virtual outreach) supports expected savings or impacts compliance. Regardless of delivery method, multiple research studies undertaken to date have found it difficult or impossible to measure the effectiveness of outreach initiatives on compliance behavior, since outreach cannot be isolated from the numerous other factors that have the potential to affect compliance. In response to recommendations in the National Taxpayer Advocate 2009 Annual Report to Congress, a research project was pursued, in part, to determine the feasibility of quantifying the extent to which the addition of outreach or education magnifies the impact of correspondence audits.[36] Several of the methods reviewed were determined to be suitable for investigating the effects of outreach and education, but it was determined they did not provide reliable quantitative estimates of those effects.

Numerous steps have been taken to alleviate customer concerns with the reduction in face-to-face events, including the following:

- Create a focus group with representatives from national practitioner organizations to obtain input on the best mix of face-to-face and virtual interactions and events;
- Develop an efficient approval process that includes partners' input to determine best outreach and education delivery options;
- Collaborate with Return Preparer Office (RPO) to identify and reach unaffiliated practitioners to provide them with greater opportunities to satisfy their CE credit requirements;
- Work with our partners to market the benefits of receiving IRS information from their desks while reducing the expense and time involved in travelling to meetings;
- Continue to successfully leverage our industry and practitioner partners in all 50 states;
- Continue the upward trend of events for limited English proficient (LEP) taxpayers;
- Continue our success with increasing the number of participants in SB/SE webinars; and
- Maintain our flexibility to redirect outreach activities as needs change.

The National Taxpayer Advocate makes four preliminary recommendations regarding outreach and education activities. The IRS is taking or has taken the following actions with respect to the recommendations:

36 SB/SE Research, Seattle, SEA 0089, *Campus Correspondence Audit Impacts (A Feasibility Study)* (Nov.2011).

In the past, SB/SE and W&I have worked closely with contractors and our research functions to measure the effect of education and outreach on taxpayer compliance. Results consistently indicate that it would be impossible to isolate the impact of education and outreach on compliance because so many other factors influence behavior.

Since the IRS does not believe it is feasible and, therefore, a good use of resources to perform research to measure the effect of outreach and education, we have no plans to suspend further implementation of our current business model pending such research.

The ability to use technology alternatives to provide presentations and information eliminates the need to have personnel physically present in each state. This approach enables us to have the technical experts participate in these events regardless of location. Our leveraged model, equipping our partners with educational and informational products and materials for their distribution to taxpayers, reaches far more taxpayers than IRS could reach alone. Additionally, the IRS will continue to use highly recognized social media venues, such as YouTube, Twitter, and Tumblr to reach on a continuous basis taxpayers across the country.

The SPEC function currently does not plan to amend its current policy approach to outreach and education initiatives. The SPEC function prioritizes outreach topics throughout the year to make the most effective use of resources. Its priority is to reach all individual taxpayers, including low-income, non-English speaking taxpayers, those with disabilities, and seniors. SPEC also plays a role in assisting other IRS operating divisions and IRS functions in reaching their target audiences as well.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate recognizes that SPEC and Stakeholder Liaison employees work hard to carry out the missions of their organizations, and that the IRS must find ways to reach more taxpayers with fewer resources. As the IRS notes, the National Taxpayer Advocate supports its expanded use of technology, and recognizes that many taxpayers may prefer to obtain information indirectly. However, she has also made clear that she does not endorse a one-size-fits-all approach to outreach and education, or strategies that serve the needs of the majority of taxpayers only.

The IRS's reach is nationwide, but the nation is comprised of innumerable communities of interest. A local presence allows the IRS to convey information and instruction with local nuance. It allows for two-way communication with taxpayers. Local employees are better positioned to inform national experts of educational needs, which in turn leads to better crafted, responsive outreach and education. The original policy of actively encouraging Revenue Officers, Revenue Agents, managers, and executives to conduct outreach was designed with this in mind — to hear local concerns, address them locally, and elevate them when guidance was needed. The shift to centralized, "leveraged" environments, unaccompanied by a local presence, may be suitable for "plain vanilla" topics and generalized advice, but is not sufficiently responsive to local concerns. There are ways to use technology well and ways to use it poorly, and the IRS is designing an outreach and education system that does not address the true diversity of our population, or, more importantly, create a two-way information exchange.

Moreover, a local IRS presence serves related purposes. For example, as described in Volume 2, TAS's survey of sole proprietors (*i.e.*, those filing Form 1040, *U.S. Individual Income Tax Return, Schedule C*) shows that noncompliance among sole proprietors is highly correlated with attitudes of *local* peer groups toward government, the IRS, and taxes.[37] Compliance is retail. The lack of a local IRS presence is a foregone opportunity to help shape local attitudes.

The National Taxpayer Advocate supports IRS initiatives that address the reduction in face-to-face events, particularly for practitioners that are unaffiliated with large professional organizations, and LEP taxpayers. However, she remains concerned about the effect of these reductions on the many individuals, small business taxpayers, and practitioners that continue to prefer face-to-face interaction with the IRS in their local communities.[38] Moreover, she is disappointed that W&I has refused to cease its "outreach for hire" approach — it will continue to only do education on a few issues, and if another part of the

37 *See Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results, infra*.

38 The IRS notes in its response that we reported only on SPEC's EITC outreach events. At the same time, the IRS admits that it cannot produce data about other outreach events for 2011 because it did not track them (or, evidently, concern itself with whether they were effective).

agency requests SPEC to do outreach on other issues, that function will have to pay for it. This approach is simply an abdication of its responsibilities to taxpayers.

The National Taxpayer Advocate is disheartened to learn the IRS no longer believes decisions about to how to communicate and interact with taxpayers should be, or even can be, driven by data about the effectiveness of the various methods of delivering services. While the IRS once embraced the need for data, it now appears to have simply given up. The IRS points to the results of a 2009 study that explored the feasibility of quantifying the extent to which the addition of outreach or education magnifies the impact of correspondence audits. The report did not address the feasibility of measuring the effect of outreach and education on taxpayer compliance generally.[39] Nevertheless, the IRS appears to view the cited study as confirmation that it need not pose to itself the problem of measuring the effectiveness of its activities in terms of taxpayer behavior.

Rather than attempting to overcome potential obstacles identified in the report, such as differences between test and control groups (a form of bias), the IRS concludes that measuring the effectiveness of its activities is simply "impossible," "because so many other factors influence behavior." We disagree. As the IRS acknowledges, bias can be minimized by establishing comparable test and control groups. TAS has worked with the IRS to accomplish this in an ongoing project with W&I and SB/SE in which a representative sample was randomly selected from a population of taxpayers whose returns had already been selected for correspondence audits. Taxpayers in this treatment group received additional education, while other taxpayers under audit did not. The tax behavior of taxpayers in each group can be studied in later periods.

That the IRS lacks information about the effectiveness of its outreach and education has not prevented it from curtailing some types of activities, a decision that has clearly burdened some taxpayers and made it more difficult for them to comply with the law. The National Taxpayer Advocate acknowledges the difficulty of identifying a causal relationship between outreach and education to taxpayers on one hand and taxpayer behavior on the other. However, she believes it is incumbent upon the IRS, when determining how best to allocate scarce resources, to continue to look for ways to measure the effectiveness of its efforts, and she urges the IRS to reconsider its position on the need for data.

39 Moreover, the report noted that the potential for improving taxpayer compliance through outreach and education has already been established by other research. According to the report, "SB/SE Research has had mixed results with field experiments related to outreach to taxpayers. For the 2006 IRS Research Conference, Adelsheim and Zanetti presented research on mass media outreach to industries in targeted geographic areas. All but two of the experiments supported a positive effect of this outreach to the taxpayers. The Denver SB/SE Research group experimented with self-correcting letters to individuals flagged by the Automated Under-Reporter (AUR) matching program. One third of the letters resulted in the taxpayer contacting the IRS for additional information and 9% resulted in amended returns; less than 0.5% of the taxpayers in the control group filed amended returns." (fn. refs. omitted.) SB/SE Research, Seattle, SEA 0089, *Campus Correspondence Audit Impacts (A Feasibility Study)* (Nov. 2011) at 13.

Recommendations

The National Taxpayer Advocate recommends that the IRS, to more effectively carry out its outreach and education responsibilities:

1. Collaborate with TAS and Compliance employees (*e.g.*, Revenue Officers and Revenue Agents) to design research initiatives to measure the effect of education and outreach methods on specific taxpayer populations or with respect to specific issues.
2. Suspend current plans to reduce in-person outreach and education to practitioners pending the outcome of such research.
3. Adjust the distribution of outreach and education staff over geographic areas in light of research findings about taxpayer characteristics in those areas.
4. Suspend the current policy of not offering outreach and education, beyond the narrow list of topics the IRS identifies, unless other government agencies or organizations agree to pay the cost.

MSP #19 A Proactive Approach to Developing a Government-Issued Debit Card to Receive Tax Refunds Will Benefit Unbanked Taxpayers

RESPONSIBLE OFFICIALS

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DEFINITION OF PROBLEM

At least 17 million U.S. adults are unbanked, lacking any type of bank account, while 51 million others are underbanked.[1] Unbanked taxpayers have no free option to electronically receive their tax refunds — *i.e.,* returns of *their* tax overpayments or other congressionally-authorized benefit transfers. For example, nearly 56 percent of the unbanked population and 18 percent of the underbanked population (amounting to over 19 million individual taxpayers) have a household income of less than $15,000, and receive an average refund of almost $1,250.[2]

The Treasury Department attempted to address this problem in the 2011 filing season when it launched a debit card pilot program to issue refunds via prepaid cards to more than 800,000 unbanked or underbanked taxpayers.[3] After analyzing the preliminary results of the pilot, Treasury decided to end the program due to low participation rates.[4] Yet, the design of the pilot may have caused the low participation. By evaluating the methodology of the pilot, with particular focus on the findings and conclusions of the Urban Institute, the IRS could develop a more effective strategy for a future debit card program.[5]

The National Taxpayer Advocate believes it is in the best interest of taxpayers and tax administration to make a government-sponsored tax refund debit card available nationwide. Treasury already uses the Direct Express Debit MasterCard to distribute federal benefits such as Social Security payments. In fact, more than 90 government-funded benefit programs already use some form of prepaid card.[6]

1 Federal Deposit Insurance Corporation (FDIC), *2011 FDIC National Survey of Unbanked and Underbanked Households, Executive Summary* 4 (Sept. 2012).

2 FDIC, *2011 FDIC National Survey of Unbanked and Underbanked Households* 23 (Sept. 2012)(Actual numbers were 55.8 percent of unbanked and 17.5 percent of underbanked). Refunds for *all* taxpayers with $15,000 or less total positive income averaged $1,247, with a median refund of $539. IRS Compliance Data Warehouse, Tax Year 2010, Individual Returns Transaction File.

3 "Unbanked" taxpayers have no checking or savings accounts. "Underbanked" taxpayers have a checking or savings account but rely on alternative financial services, such as commercial check cashing services, refund anticipation loans, pawnshops, and money orders. Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* ES-1 (Sept. 2012).

4 Eric Kroh, *Treasury Won't Renew Debit Card Refund Program in 2012, Spokesman Confirms*, Tax Notes Today (Nov. 1, 2011).

5 Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* (Sept. 2012).

6 *See* http://www.fms.treas.gov/directexpresscard/index.html (last visited Sept. 9, 2012); Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* 3 (Sept. 2012).

In addition, the National Taxpayer Advocate remains concerned about the incorporation of the existing Western Union MoneyWise prepaid card into the TaxWise preparation software used at most Volunteer Income Tax Assistance (VITA) sites. The IRS has partnered with several financial institutions to offer refunds on debit cards offered by VITA and Tax Counseling for the Elderly (TCE) organizations, but claims it does not endorse any particular product. However, the IRS provides volunteer sites with free CCH TaxWise software, which incorporates a Western Union debit card product, and the terms associated with this particular product appear less favorable than for other products.[7] The National Taxpayer Advocate requested a copy of the contract from the IRS, but the IRS declined to provide her with a copy of the contract unless CCH/TaxWise consented pursuant to an exemption to the Freedom of Information Act. The National Taxpayer Advocate plans to review the contract to effectively discharge her statutory tax administration duties.[8]

ANALYSIS OF PROBLEM

A Government-Sponsored Nationwide Debit Card Program for Tax Refunds Would Benefit Both Taxpayers and Tax Administration.

A nationwide debit card program to distribute tax refunds benefits both unbanked taxpayers and the government.[9] Taxpayers would benefit in the following ways:

- **Quick Refund Turnaround and Minimal Cost.** An electronic refund (coupled with electronic filing) is the fastest refund delivery mechanism. Direct deposit is an ideal method of receipt, with no cost to the taxpayer. Unbanked taxpayers cannot benefit from the use of direct deposit and consequently have no way to receive refunds electronically, quickly, and free. As a result, they must either wait longer to receive refunds by paper check, and potentially incur high check-cashing fees, or purchase a high-cost commercial refund delivery product. If the system were planned properly, taxpayers would not incur high fees to access funds deposited onto a government-sponsored debit card.

  To illustrate the importance of quick refund turnaround and low cost access to refunds, it is necessary to understand the financial status of the unbanked and

7 Western Union MoneyWise Prepaid MasterCard Overview, http://cchsfs-taxwise.custhelp.com/app/answers/detail/a_id/382/~/western-union-moneywise-prepaid-mastercard-overview (last visited Sept. 9, 2012); Government Accountability Office (GAO), GAO-11-481, *2011 Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance 38* (Mar. 2011).

8 The Freedom of Information Act (FOIA) is a law ensuring public access to U.S. government records. 5 U.S.C. § 552. However, the Act provides several exemptions to the general presumption of mandatory disclosure. Section 552(b)(4) exempts from disclosure "[t]rade secrets and commercial or financial information obtained from a person and privileged or confidential." IRM 11.3.13.9.2(8) (Jan. 1, 2006) provides "Contracts and related records, including evaluative records, concerning the purchase of goods and services are agency records, but they may contain trade secrets and commercial or financial information which is privileged or confidential. Vendors frequently provide the government with more information concerning their products or services than they would make available in ordinary trade." *See* also Treas. Reg. § 601.702(g) (requiring notice of a request to the contractor); Treas. Reg. § 301.9000-3(b)(2), -4(f) (regarding disclosures in connection with testimony before Congress). Accordingly, the National Taxpayer Advocate has the authority to review the agency record upon providing appropriate assurances that we will not disclose any confidential information to the public.

9 GAO, GAO-11-481, *2011 Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance* 4 (Mar. 31, 2011). For a comprehensive discussion of prepaid card features, see Michelle Jun, Consumers Union, *Prepaid Cards: Second-Tier Bank Account Substitutes* (Sept. 2010).

underbanked. The following table sets forth the income levels and average refund amounts for these populations:

TABLE 1.19.1, Financial Status of the Unbanked and Underbanked Population[10]

Household Annual Income Level	Percentage of Unbanked Population	Percentage of Underbanked Population	Average/Median Refund in Income Range	Total Number of Individual Income Tax Returns in this Income Level
Less than $15,000	55.8 %	17.5%	$1,247 / $539	35.3 million
$15,000 to $30,000	26.1%	23.3%	$2,454 / $1,430	30.2 million
More than $30,000	18.1%	59.2%	$2,066 / $1,730	76 million

- **Improve Financial Literacy.** A debit card program would improve the financial literacy of taxpayers by providing the unbanked with access to an ongoing financial account to obtain banking services, *i.e.,* a steppingstone to becoming comfortable with financial institutions and banking activity.
- **Fraud Protection.** Debit cards can protect taxpayers whose cards are lost or stolen. Commercial debit cards have recently been used to commit fraud.[11] Identity thieves obtain Social Security numbers, file returns using the real taxpayer's name and a fictitious income, buy a commercial debit card, and ask the IRS to issue the refund to that card. Law enforcement officials have suggested the IRS prohibit use of debit cards to curtail the fraudulent activity. However, the government can work with the private sector, which has experience in managing debit and credit card fraud, to design a program with the least risk.

The government benefits from a debit card program in the following ways:

- **Reduced costs.** When more taxpayers receive refunds electronically, the government reduces check printing and mailing expenses. However, a debit card program is not without costs, especially for distribution of the cards. The key to a cost-effective program is to encourage taxpayers to use the card over several years and eventually switch to direct deposit.
- **Control Over Card Features and Marketing.** By sponsoring its own card, the government will be able to use its purchasing power to exercise some level of control over the features of the card, the fees, and the messages to taxpayers.

10 The unbanked and underbanked data reflect 2011 household income data. FDIC, 2011 *FDIC National Survey of Unbanked and Underbanked Households 23* (Sept. 2012). However, the average and median refund data reflect tax year 2010 data and correlates to total positive income (TPI). IRS Compliance Data Warehouse, Tax Year 2010, Individual Returns Transaction File.

11 Scott Zamost and Randi Kaye, *IRS Policies Help Fuel Tax Refund Fraud, Officials Say, CNN.com* (Mar. 20, 2012).

The National Taxpayer Advocate, the Federal Government, and the Urban Institute Have Recognized the Benefits of a Debit Card Program.

The National Taxpayer Advocate and Treasury agree that a debit card program would benefit both unbanked taxpayers and tax administration. In the 2008 and 2011 Annual Reports to Congress, the National Taxpayer Advocate recommended that Treasury enable unbanked taxpayers to receive refunds on stored value cards (SVCs) or debit cards.[12]

The federal government already directly participates in the debit card market outside the tax system, as more than 90 government-funded programs use some form of prepaid card to deliver benefits. In 2008, Treasury launched the Direct Express Debit MasterCard, used by over 2.5 million individuals to receive federal benefits (such as Social Security payments), pay bills, make purchases, and access cash.[13] In addition, almost all VITA and TCE sites offer at least one commercial debit card product.

Citing the benefits of debit cards for both the government and taxpayers, Treasury began pilot-testing a tax refund debit card program in the 2011 filing season. The Tax Time Account Direct Mail Pilot offered refunds on debit cards to more than 800,000 low income taxpayers, who had less than $35,000 per year in household income and were believed to have lived in unbanked or underbanked households.[14] Taxpayers received a reloadable Visa-branded debit card called MyAccountCard from a bank selected by Treasury, and were randomly assigned one of eight offers to test how they would respond to different offers.[15] The pilot was not designed to measure overall take-up but to test the effects of different aspects of the card offers on take-up. Therefore, the recipients were divided into eight treatment groups based on the type of offer they received. The offers varied in the following ways:

- Monthly fee (either no fee or $4.95);
- Whether the card had access to a savings account:
- The promotion message (either convenience or safety); and
- The timing of the mailing (late January or mid-February).[16]

12 National Taxpayer Advocate 2008 Annual Report to Congress 423-26 (Legislative Recommendation: *Refund Delivery Options*); National Taxpayer Advocate 2011 Annual Report to Congress 404-19 (Most Serious Problem: *After Refund Anticipation Loans: Taxpayers Require Improved Education About Refund Delivery Options and the Availability of a Government-Sponsored Debit Card*).

13 *See* http://www.fms.treas.gov/directexpresscard/index.html (last visited Sept. 9, 2012); Caroline Ratcliffe, Signe-Mary McKernan, Urban *Institute, Tax Time Account Direct Mail Pilot Evaluation* 3 (Sept. 2012).

14 The pilot sent offers to 808,099 taxpayers believed to be unbanked or underbanked. The household likelihood of being unbanked or underbanked was a variable constructed by Experian Marketing Solutions Inc. using commercially available data and was based on a statistical model that produced an underbanked score. *Id*. at ES-2, 3.

15 Treasury selected Bonneville Bank for the pilot and Bonneville selected Green Dot to provide card-processing services for the debit card that could be used at any point-of-sale terminal that accepts VISA cards worldwide. Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* ES-1 (Sept. 2012).

16 *Id*.

Treasury expected a low take-up rate, as with most direct mailing campaigns, and contracted with the Urban Institute to evaluate the program.[17] Fewer than 2,000 of the over 800,000 people who were offered the cards applied for them, a take-up rate of approximately 0.3 percent.[18] As a result, Treasury ended the pilot after the 2011 filing season, citing low participation.

The Urban Institute released a report evaluating the MyAccountCard Tax Time pilot in September 2012. Notably, the report provided "[i]n sum, the federal government's creation of an option for tax filers to receive refunds directly onto a low-cost, account-linked card, as tested in this pilot, is a concept with promise."[19] It also offered the following findings:[20]

- The Urban Institute acknowledged the low take-up rate, but recognized that 0.3 percent was within the 0.3 percent to 0.8 percent range for credit card direct-mail take-up rates experienced in recent years.
- The take-up rate was significantly higher for individuals who were most likely to live in unbanked households. This group had a 0.8 percent take-up rate, nearly three times the rate for the full pilot population and at the upper end of the expected rate for direct mail card offers.
- Only 16 percent of all cardholders and 48 percent of those with active accounts actually used the card as originally intended and direct deposited their refunds into the card account.
- Charging a $4.95 monthly maintenance fee decreased card applications by 42 percent. In addition, the likelihood of using the card within six months of receiving it was 47 percent lower for recipients of cards with the fee.
- Linking a savings account to the card had virtually no impact on take-up.
- Product messaging (safety versus convenience) did not significantly influence behavior.
- The timing of the card offer had a significant impact on the take-up rate. People who were mailed the offer in mid-January were 85 percent more likely to apply than those who received it in early February.[21]

17 GAO, GAO-11-481, *2011 Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance* 17, 39 (Mar. 31, 2011); *Hearing on Financial Literacy: Empowering Americans to Make Informed Financial Decisions, Subcomm. on Oversight of Government Management, the Federal Workforce, and the District of Columbia*, S. Comm. on Homeland Security and Governmental Affairs, 112th Cong. (Apr. 12, 2011) (testimony of Acting Director Joshua Wright, Office of Financial Education and Financial Access, U.S. Department of the Treasury); Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* ES-2 (Sept. 2012).

18 Eric Kroh, *Treasury Won't Renew Debit Card Refund Program in 2012, Spokesman Confirms*, Tax Notes Today (Nov. 1, 2011); Financial Management Service (FMS) Briefing to TAS by Phone (Sept. 5, 2012). Overall, 1,967 people (0.3 percent of the offer recipients) applied for the prepaid card, of which 1,933 individuals (98.3 percent of applicants) were issued the card. Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* ES-3 (Sept. 2012).

19 Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* ES-5 (Sept. 2012).

20 *Id.* at ES-3-4, 4, 7, 14, 15, 18, 19, 28.

21 The two-tiered mailing was not originally planned but was conducted consistently across the eight treatment groups. Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* 7 (Sept. 2012).

Based on the findings of the pilot study, the Urban Institute suggested the following steps to increase take-up rates in any future debit card program:[22]

- Offer an account with a monthly fee as low as possible, even at the expense of other card features such as savings account linkage.
- Distribute and make the cards available before the tax-filing season begins.
- Offer the card directly in the filing and refund process to reduce barriers to application.
- Remove the multi-step application and deposit process for simplicity.
- Enable taxpayers to use the card to pay tax preparation fees.
- Publicize the card broadly and before the tax season to increase familiarity with the product. A comprehensive informational "surround sound" campaign would use earned and paid media and community partners to make the public aware of the card's existence and the application process. The 2011 pilot did not include a comprehensive marketing campaign because the administrators did not want to contaminate comparisons across the different categories of offer recipients.
- Accept individual taxpayer identification numbers (ITINs) to increase the take-up rate. The pilot only accepted applications with Social Security numbers.

Notwithstanding Termination of the 2011 Treasury Debit Card Pilot, a Nationwide Program Could Succeed With Improved Marketing and Distribution.

We are disappointed that Treasury discontinued the debit card pilot after just one filing season. We realize that participation was lower than expected, perhaps because direct mailing did not work well with this population. However, the IRS and Treasury may be able to reach more unbanked and underbanked taxpayers by evaluating the pilot and the Urban Institute report to develop a more successful distribution and marketing strategy.

The IRS's response to the related Most Serious Problem in the National Taxpayer Advocate's 2011 Annual Report to Congress merely stated:

> Due to the low participation rate, Treasury made a decision to terminate the 2011 Treasury-sponsored debit card pilot for tax refunds and will not offer the cards during the 2012 filing season. If Treasury considers sponsoring a debit card for tax refunds in future tax years, the IRS would work with it to explore the feasibility and options.[23]

The National Taxpayer Advocate believes the IRS's response displays remarkable passivity in the face of the need of unbanked and underbanked taxpayers. The IRS should engage with Treasury and the Taxpayer Advocate Service to take a more proactive role in

22 Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* ES-3 to -5, 4, 5 (Sept. 2012).

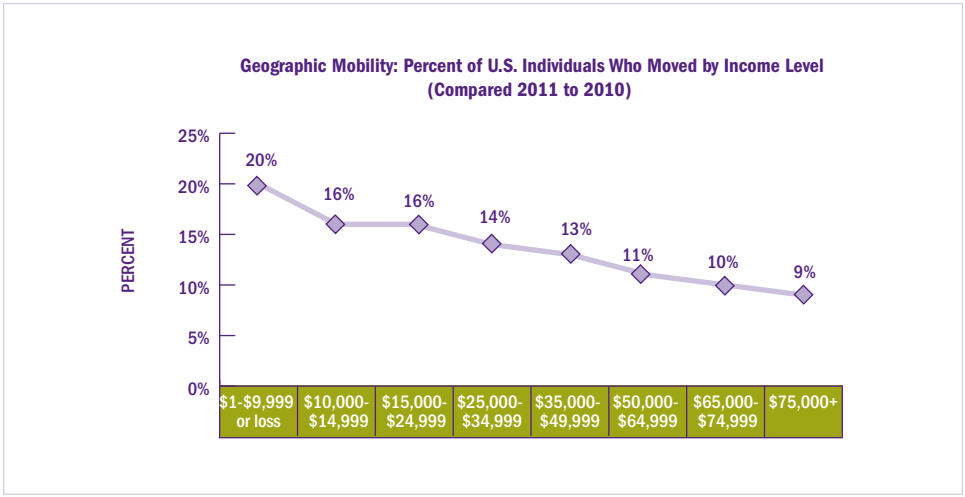
23 National Taxpayer Advocate 2011 Annual Report to Congress 416.

developing a future project based on the experience and lessons learned from the 2011 pilot, with particular focus on the findings and conclusions of the Urban Institute.

As mentioned in the Urban Institute report, the distribution channels and application process used in the 2011 pilot proved problematic. The direct-mail approach may not be particularly useful, especially given the transient nature of this population. At the very least, potential users should be offered the cards well in advance of the filing season.

To illustrate the high mobility of this population, the following chart sets forth the percentage of individuals with income who moved in 2011, by income category. It illustrates that those at lower income levels generally have a higher degree of mobility than others with higher income.[24]

FIGURE 1.19.2, Individuals Who Moved by Income Category



Further, as discussed in the Urban Institute report, taxpayers may be more willing to participate if the application process was streamlined and, ideally, incorporated into the tax filing process by including it on IRS forms.

Another potential distribution channel would be to make the card application process available through the U.S. Post Office, similar to passport applications, or through banking institutions.[25] For example, taxpayers could indicate on their returns that they would like their

24 U.S. Census Bureau, 2011 American Community Survey 1-Year Estimates, B07010: *Geographical Mobility in the Past Year by Individual Income in the Past 12 Months (In 2011)* (the percentage numbers reflect the portion of the total population of individuals with income who moved, or who stayed in the same location, as the case may be).

25 In Australia, individuals can obtain a Load&Go card at the post office. This product is a reloadable Visa prepaid debit card. For more information, see http://auspost.com.au/personal/what-is-loadandgo-card.html (last visited Sept. 8, 2012). In the United Kingdom, taxpayers can receive the child benefit, tax credits, and Guardian's Allowance on the Post Office card account, which is administered at local post offices. HM Revenue & Customs, *How Child Benefit, tax credits and Guardian Allowance are paid*, http://www.hmrc.gov.uk/childbenefit/payments-entitlements/payments/how-paid.htm (Last visited Sept. 9, 2012).

refunds delivered on the government debit card. Once the IRS accepts and processes the taxpayer's return, the taxpayer could go to any banking institution and receive the loaded debit card, upon proof of identity. (This approach significantly addresses law enforcement concerns about identity theft.) No matter which distribution channel the IRS chooses, the program must include a comprehensive public awareness campaign to spread the word to the target taxpayers and the preparers serving them.

In addition, our office discussed the 2011 pilot and the potential for a future debit card program with officials of the Financial Management Service (FMS). Based on these conversations, we have learned several interesting facts:[26]

- **The Direct Mailing List Used in the 2011 Pilot May Not Have Been Optimal.** When designing the project, the team planned to target unbanked and underbanked taxpayers, and initially attempted to obtain a list of Earned Income Tax Credit (EITC) recipients as the target audience. However, information-sharing issues prevented the IRS from providing this tax data.[27] Therefore, the team obtained the necessary list from an outside party. The quality of this list may not have been optimal for the project, which may explain why so few responded and so many mailings were returned as undeliverable.[28] Further, the third-party data could not distinguish between those with Social Security numbers, required for the pilot, and those without.[29]
- **Application During the Tax Filing Process.** As mentioned in the Urban Institute report, an effective application process and distribution channel for the debit cards are imperative. To make the take-up rate high enough to make the project successful and financially viable, the IRS may need to give taxpayers a way to apply for the card during the tax filing process. This would require changes to the Form 1040 series to allow taxpayers to opt in to the program and consent to share information with the financial institutions issuing the cards. The government can either collaborate with one financial institution for simplicity or provide the taxpayer with a choice of several institutions with which the government has negotiated appropriate terms. Certain financial institutions may have a larger presence in different geographic regions. The IRS would need to work proactively with Treasury to determine the most administratively feasible and effective approach.
- **Current Technology Cannot Deliver All Government Benefits Through One Government Card.** It is not possible with current technology to distribute federal payments such as Social Security Administration (SSA), Railroad Retirement (RR), and Veteran's Affairs (VA) benefits on the same card as tax refunds. Certain federal benefit payments are exempt from garnishment orders received and executed by financial

26 FMS briefing to TAS by phone (Sept. 5, 2012).

27 IRC § 6103.

28 The list was not optimal for several reasons, including: (1) The list could not exclude individuals without Social Security numbers, a requirement for pilot participation; (2) Whether an individual was unbanked or underbanked was predicted based on multiple variables from several sources. Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* 5, 9 (Sept. 2012).

29 The high rate of undeliverable mail may also be explained by the transient nature of the unbanked and underbanked population.

institutions.[30] It is our understanding that debit cards are linked to one account with no ability to place the protected and unprotected funds in separate "buckets." If a financial institution receives a garnishment order, it has no way to identify which funds in the debit card account are protected federal benefits once the funds are commingled with other unprotected funds, such as tax refunds. Thus, it is currently impossible to consolidate all government-sponsored debit card programs into one. However, future technology is expected to allow taxpayers to designate at the point of sale the "bucket" from which the funds should originate, which would isolate the funds derived from protected benefits from the unprotected funds.[31]

- **Source of Funds is Limited.** During the 2011 pilot, it became apparent that financial institutions resist allowing the cards to load payments other than government payments due to the risk of fraud. Any additional risk to the bank increases the potential fees imposed on the cardholders. For example, unbanked taxpayers would benefit from receiving tax refunds and payroll funds on a single card. However, if a bad or stolen check is deposited into an account and the funds are made immediately available but the check does not subsequently clear, the bank loses the money.[32] To compensate for this additional risk exposure, the bank may charge fees at a level unacceptably high for a government-sponsored card. The government could attempt to alleviate this risk by accumulating a list of trusted partner payroll providers and large employers, but this approach would raise the issue of fairness if it appears the government is selecting certain employers over others. This approval process may also be cost-prohibitive for the government.

Many unbanked and underbanked taxpayers already own a debit card. It is our understanding that the IRS cannot distinguish between a traditional bank account and an account linked to a debit card when it releases a refund.[33] After analyzing any potential fraud or security risks, the IRS and Treasury can collaborate with private industry to inform taxpayers that they already have access to an electronic refund delivery option and can avoid incurring unnecessary fees to access the refund quickly. This endeavor will require the participation of the private sector because not all cards will allow deposits from multiple sources and the account numbers on the faces of the cards are not the same as the numbers required for tax filing. Taxpayers would need to check with their financial institutions about the details specific to their own cards.[34]

30 31 C.F.R. § 212.6; Department of Treasury, FMS, *Guidelines for Garnishment of Accounts Containing Federal Benefit Payments* (March 2011). In 2009, the National Taxpayer Advocate recommended that Congress amend IRC § 6402 to prohibit the Secretary from offsetting a taxpayer's refund by more than 15 percent of the portion attributable to the earned income tax credit (EITC). National Taxpayer Advocate 2009 Annual Report to Congress 365-70.

31 FMS briefing to TAS by phone (Sept. 5, 2012).

32 The same issue arises with check-kiting schemes. FMS briefing to TAS by phone (Sept. 5, 2012); FMS briefing to TAS (Sept. 27, 2012).

33 FMS briefing to TAS by phone (Sept. 5, 2012); IRM 21.4.1.4.7 (July 12, 2012).

34 FMS briefing to TAS by phone (Sept. 5, 2012).

An Aggressive Response is Necessary to Address the Incorporation of a Western Union Product into TaxWise.

The IRS claims it does not endorse any particular debit card product. However, the National Taxpayer Advocate believes the incorporation of Western Union's MoneyWise prepaid card in the TaxWise software, which the IRS provides to VITA and TCE sites free of charge, creates an unfair advantage and an indirect endorsement by the IRS. When the National Taxpayer Advocate raised this issue in the 2011 Annual Report, the IRS responded that the debit card feature was not part of the software when the IRS entered into the CCH contract.[35] In return, we urged the IRS to eliminate all references to the commercial product in TaxWise software and marketing materials.[36] However, it is our understanding that the product is still incorporated into TaxWise.[37] In fact, the IRS receives a monthly activity report from TaxWise including data on the number of cards issued. As of September 1, 2012, over 4,000 taxpayers using VITA services purchased the product.[38]

We believe the IRS is not acting aggressively enough to protect taxpayers in this instance.[39] If the product was added to the software without IRS approval, the IRS likely has the authority under the existing contract to demand that it be eliminated immediately. Conversely, if the product was added with IRS approval, it is an improper endorsement and gives an unfair edge to a relatively high-fee commercial option. The IRS should review the terms of the contract to pursue the immediate elimination of all references by TaxWise to the debit card product in software packages and marketing materials distributed to volunteer sites. Once the product is removed, it can be offered externally with other debit card products.

Further, when the IRS renegotiates the contract with CCH for VITA/TCE electronic preparation and transmission of returns, we urge the IRS to address debit cards as well as other commercial refund products. The IRS has the authority to review the terms of all commercial products offered through the software, and should require the vendor to seek IRS approval before marketing any such product on software for volunteer organizations.

35 IRS response to Most Serious Problem, National Taxpayer Advocate 2011 Annual Report to Congress 410, 415.

36 National Taxpayer Advocate 2011 Annual Report to Congress 417.

37 *See Western Union MoneyWise Prepaid MasterCard Overview*, http://cchsfs-taxwise.custhelp.com/app/answers/detail/a_id/382/~/western-union-moneywise-prepaid-mastercard-overview (last visited Sept. 9, 2012); TaxWise Desktop, *Applying for the MoneyWise Card in a Return*, *available at* http://tax-coalition.org/program-tools/financial-services/asset-building/asset-building-products/debit-cards/western-union-moneywise-card/taxwise-desktop-moneywise (last visited Sept. 9, 2012); GAO, GAO-11-481, *2011 Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance* 38 (Mar. 2011).

38 According to IRS monthly reports, 4,047 taxpayers purchased the product. IRS response to TAS information request (Oct. 4, 2012).

39 For a list of the various fees charged by the debit cards offered at VITA/TCE sites during the 2011 filing season, see GAO, GAO-11-481, *2011 Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance* 38 (Mar. 2011). For example, all of the programs had such favorable terms as free activation and monthly maintenance on all programs. However, the Western Union program seemed to have the highest transactional fees, with $1.95 per ATM withdrawal fees, $4.95 cash reload fees, and no relationship building with any financial institution.

Moreover, the IRS should make it clear to the VITA/TCE partners and their customers that it does not endorse any commercial refund products.[40]

CONCLUSION

The IRS and Treasury need to take a more proactive approach to providing a free electronic refund delivery option to unbanked and underbanked taxpayers. Treasury took an important first step when it conducted the 2011 debit card pilot. While Treasury unfortunately terminated the pilot after only one filing season, the pilot findings and the evaluation by the Urban Institute provide valuable information for designing a nationwide program.

In addition, we remain concerned that TaxWise, the tax preparation software provided free of charge by the IRS to VITA and TCE organizations, continues to incorporate the Western Union MoneyWise prepaid card into program. The IRS has no control over the terms associated with this product, yet appears to endorse the product by allowing the software to offer it.

IRS COMMENTS

The IRS provides several options to taxpayers for receiving their federal income tax refunds. The IRS delivers extensive communications and outreach during each filing season on the refund delivery options and encourages taxpayers to consider electronic options such as direct deposit into their checking or savings account since it gives them access to their refund faster than a paper check. It also avoids the possibility that a check could be lost or stolen or returned to IRS as undeliverable. Taxpayers may also split their refunds with direct deposits into two or three of their accounts and consider receiving their refund electronically on a commercially-provided debit card.

In this report, the National Taxpayer Advocate suggests that the IRS make a government-sponsored tax refund debit card available nationwide. In 2011, Treasury launched this option through a pilot program called MyAccountCard (MAC) offering a selected group of low- to mid-income taxpayers the opportunity to receive their refunds in the form of a prepaid debit card. Only taxpayers who received a letter from Treasury were eligible to apply for the program. Treasury offered variations of MAC through three different financial institutions to evaluate which product features, fee structures, and marketing messages generated the greatest positive taxpayer response. Treasury made a decision to terminate the debit card pilot for refunds and did not offer it for the 2012 filing season. The IRS will work with the Treasury Department if it decides to explore a similar option in the future.

40 In a 2011, the IRS Wage & Investment Research organization conducted eight focus groups in four geographically dispersed cities to obtain taxpayers' input on their experiences with VITA. The report noted a "[g]eneral disinterest in investing in savings bonds and receiving pre-paid debit cards." This finding is worthy of further investigation. W&I Research & Analysis, 2011 Taxpayer Experience Focus Groups, Project Briefing for Stakeholder Partnerships, Education & Communication (SPEC), Slide 12, Project # 4-10-01-S-058 (July 2011).

VITA/TCE partners can select a software program that may offer a commercial debit card, as long as that software meets the IRS guidelines for tax preparation and return submission. These sites are not required to report the offering of debit cards, and the IRS does not generally track debit card offerings. However, the IRS does have information on debit cards offered last year through the software contract with CCH TaxWise, a commercial-off-the-shelf tax preparation and transmission product. As of September 1, 2012, eight percent of VITA/TCE sites (1,076/13,143 sites) offered Western Union debit cards in lieu of paper checks. These sites issued a total of 4,047 debit cards, which represents over one-tenth of one percent (.12 percent) of all returns prepared through the VITA/TCE program (4,047/3,267,997).

In December 2009, the IRS awarded a new software contract to CCH for the purchase of TaxWise software. The debit card feature was incorporated into this software subsequent to the award of the contract. The National Taxpayer Advocate has requested that the IRS immediately require the CCH to remove all references to the Western Union debit card product from the standard TaxWise software the IRS provides to VITA/TCE sites. In response to concerns raised by the National Taxpayer Advocate, the IRS has requested that CCH block access to the debit card feature in the software in the TY 2012 filing season. As noted in our response to the MSP on Return Filing Options, the new 2014 contract will also include a prohibition on offering a debit card product in software purchased by the IRS.

The National Taxpayer Advocate recommends that the IRS undertake an aggressive public awareness campaign to educate taxpayers about the reduced return processing time as well as its impact on refund turnaround times for government-sponsored refund options. While the IRS can predict a general refund delivery timeframe, it cannot predict which taxpayers will fall outside that timeframe or why. We have found it most helpful for taxpayers to communicate realistic refund delivery times. Analysis of call center traffic, focus group results, feedback from the tax preparer and tax software industries, combined with IRS experience, support the conclusion that taxpayers will count on the best case scenario for refund issuance if IRS sets expectations for consumers using a range (ten to 21 days, for example). Despite caveats and cautious language, taxpayers who want their refunds faster consistently count on the nearest date and call in frustration when their expectations are not met. Not only is this not in the taxpayer's best interest, but it also puts unnecessary pressure on the IRS and tax industry customer service operations, diverting services from other taxpayer needs.

In 2013, we will implement consumer messaging, setting a general expectation for refunds in less than 21 days, and directing taxpayers to the *Where's My Refund* tool where they will see information about their own personal refund instead of a generic, estimated date. This year, taxpayers will be able to start checking on the status of their return within 24 hours (instead of 72) after the IRS has received an e-filed return. Also in 2013, *Where's My Refund* will include a tracker that displays progress through the following three stages: (1) Return Received, (2) Refund Approved and (3) Refund Sent.

The IRS has considered stakeholder feedback and is committed to working together with stakeholders to set expectations for refund communications and implement suggested changes to *Where's My Refund*. The IRS expects that each of those initiatives will improve the taxpayer's ability to understand their refund status. The IRS will also continue to deliver messaging during filing season that the fastest way to get a tax refund is to use free file or e-file to ensure an accurate tax return in addition to promoting the direct deposit option. While the IRS works hard to issue refunds as quickly as possible, some tax returns take longer to process than others for many reasons, including when a return has errors, is incomplete or needs further review. We will ensure that taxpayers are informed as to realistic expectations.

Taxpayer Advocate Service Comments

The IRS's response regarding the development of a government-sponsored debit card continues to display remarkable passivity in the face of the need of unbanked and underbanked taxpayers to receive their refunds electronically free of charge. The IRS offered a similar response to the related Most Serious Problem in the National Taxpayer Advocate's 2011 Annual Report to Congress.[41] The National Taxpayer Advocate strongly believes it is in the best interest of taxpayers and tax administration to make a government-sponsored tax refund debit card available nationwide. Accordingly, the IRS should engage with Treasury and the Taxpayer Advocate Service to proactively develop a future project, based on the experience and lessons learned from the 2011 pilot, with particular focus on the findings and conclusions of the Urban Institute.

The National Taxpayer Advocate commends the IRS for taking a firm stance against the incorporation of the Western Union debit card in TaxWise software for VITA and TCE sites. By requesting that CCH block access to this feature during the coming filing season, the IRS has sent a strong message that it will not tolerate the inclusion of commercial refund products in software provided to volunteers without prior IRS approval. In addition, the planned prohibition on such products in the 2014 contract with CCH will resolve the issue in the future.

Finally, we continue to believe that taxpayers can make more informed decisions about whether to buy commercial refund delivery products if an aggressive IRS public awareness campaign provides information on refund turnaround times for various delivery methods in the previous filing season. We understand that the IRS has competing concerns in this area because any deviation from the times provided in such communications will drive taxpayers to call the IRS and drain already scarce resources. However, carefully drafted messages could set forth the expected range for the current year as well as actual times

41 See National Taxpayer Advocate 2011 Annual Report to Congress 414-16.

experienced in the past. If they know the actual average times from the last filing season, taxpayers can form realistic expectations and have the information they need to determine before they file their return which refund delivery method is best for them. Once they have filed, taxpayers can use the enhanced "Where's My Refund" application to keep informed about the status of their refunds and receive more detailed information regarding the estimated delivery date. The new, more tailored features of "Where's My Refund" should help to manage taxpayers' expectations about refund delivery, and we commend the IRS for these refinements.

Recommendations

The National Taxpayer Advocate recommends that the IRS take the following actions to better serve unbanked and underbanked taxpayers:

1. In collaboration with the Department of Treasury and the Office of the Taxpayer Advocate, establish a task force to evaluate the results of the Treasury debit card pilot, with a particular focus on the Urban Institute report, to design a more effective future nationwide program. The team should review the feasibility of incorporating the application process into the tax-filing process as well as distribution of the cards through the post office and financial institutions, and should confer with the private and nonprofit sectors about security and consumer protection issues.
2. Provide the National Taxpayer Advocate with a complete copy of the agreement with CCH concerning the TaxWise product used in the VITA program, and any forthcoming Requests for Proposals pertaining to VITA software procurement, prior to public announcement.
3. If the IRS wants the software it provides to VITA/TCE sites to include a debit card product, explicitly state that requirement in its Request for Proposal and separately negotiate terms for debit card services.
4. Undertake an aggressive public awareness campaign to educate taxpayers about the reduced return processing time, as well as its impact on refund turnaround times, for government-sponsored refund options. This campaign should inform taxpayers about actual turnaround times during the previous filing season and advise taxpayers to ask certain questions about card features before purchasing a commercial refund product, such as a debit card.

Introduction to Collection Issues: The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes

OVERVIEW

In fiscal years (FY) 2011 and 2012, the IRS implemented a series of significant operational policy changes collectively known as the "Fresh Start" initiative. Primarily focused on collection policies and procedures, the "Fresh Start" initiative has produced some of the most significant changes to the IRS Collection program in well over a decade, particularly in the areas of flexible payment options, lien-filing practices, and flexibility in issuing lien withdrawals.

In FY 2011, the IRS modified the criteria used in filing Notices of Federal Tax Lien (NFTL), issued expanded guidance enabling more taxpayers to request and obtain lien withdrawals, expanded the criteria under which small businesses may pay past due taxes in installments, and formalized the "streamlined" offer in compromise (OIC) procedures used by the IRS's centralized OIC operation.[1]

In FY 2012, the IRS announced expanded criteria for individual taxpayers to qualify for "streamlined" installment agreements (IAs), and provided an opportunity for a six-month grace period on failure-to-pay penalties for certain wage earners and self-employed taxpayers.[2] In May 2012, the IRS expanded its "Fresh Start" initiative further by offering more flexible terms to the OIC program in an effort to allow some of the most financially distressed taxpayers to clear up their tax problems.[3] New procedures issued concurrently provided more flexibility to collectors in conducting financial analysis to determine the payment options available to delinquent taxpayers. In October 2012, the IRS formalized this guidance in a published revision of the Financial Analysis Handbook (Internal Revenue Manual (IRM) 5.15.1).

With the focus on liens and collection payment options, the National Taxpayer Advocate acknowledges the efforts of the IRS to address collection issues that are highly significant to taxpayers struggling to resolve delinquent tax debts. Past Annual Reports to Congress have addressed these issues, and significant portions of the "Fresh Start" initiative reflect recommendations by the National Taxpayer Advocate.[4] As a result, TAS has worked exten-

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

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

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

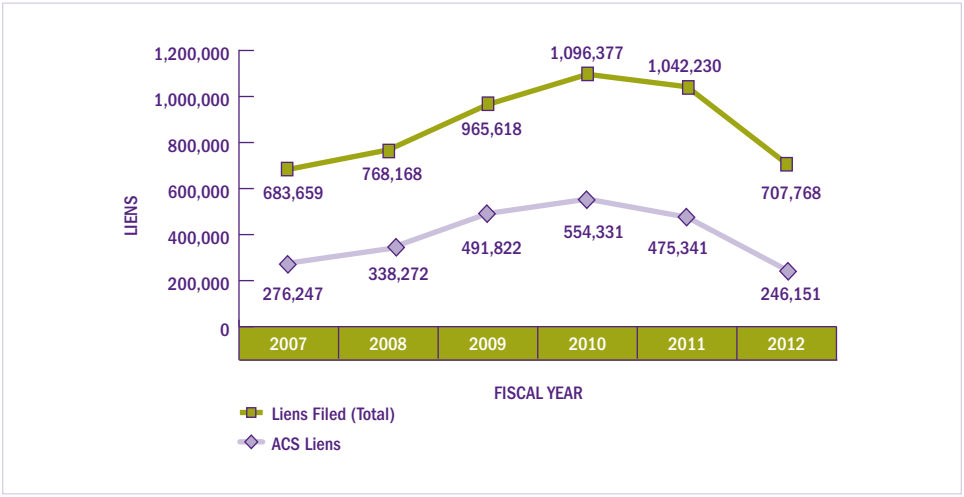
4 National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 39-70 (Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*); National Taxpayer Advocate 2010 Annual Report to Congress 302-310 (Status Update: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

sively with the IRS on the development of the "Fresh Start" implementation guidance, and has monitored the impact of the initiative in several key areas.

The IRS has filed fewer liens, but the lack of sound judgment in lien-filing decisions remains a problem.

In FY 2012, the IRS filed 32 percent fewer NFTLs than in FY 2011, including a corresponding 48 percent reduction in liens filed by the Automated Collection System (ACS).[5]

FIGURE 1.1, Lien Filings FY 2007–2012



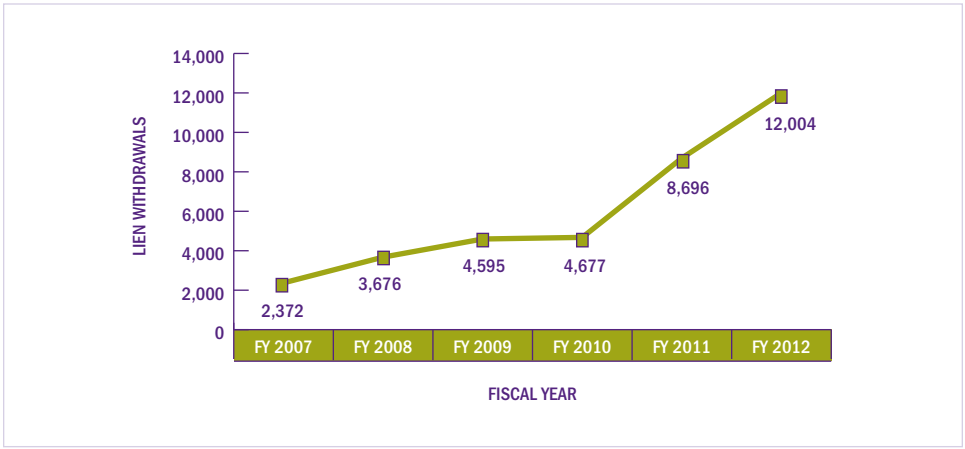
Also in FY 2012, thousands of financially struggling taxpayers have successfully obtained lien withdrawals to help regain their financial viability.[6] The number of withdrawals issued by the IRS in FY 2012 increased 157 percent over FY 2010.[7] These results indicate that components of the "Fresh Start" initiative have produced significant changes in IRS practices involving Notices of Federal Tax Lien (NFTL), which in turn have had positive, meaningful results for many taxpayers.

5 IRS, Collection Activity Report, NO-5000-25, *Liens Report* (Oct. 2012).

6 *Id.* Through September 2012, the IRS issued 12,004 lien withdrawals.

7 IRS response to TAS information request (Aug. 14, 2012). In FY 2010, the IRS issued 4,677 lien withdrawals.

FIGURE 1.2, Lien Withdrawals FY 2007-2012



While the overall reduction in lien filings is a positive change for many taxpayers, the National Taxpayer Advocate continues to urge the IRS to base lien-filing decisions on a thorough analysis of the facts and circumstances of each case, and not simply rely on an arbitrary dollar figure representing unpaid liabilities. Only in this manner can the IRS properly balance the government's interests in protecting revenue with the taxpayer's interest in maintaining financial viability and future compliance.

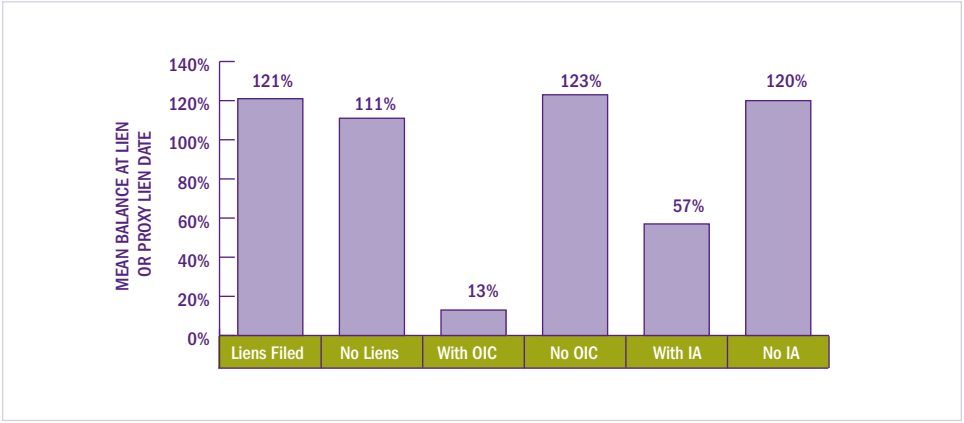
In the 2011 Annual Report to Congress, TAS shared with the IRS the results of a TAS research study that shows how indiscriminate lien filings may actually have a negative influence on revenue collection and future filing compliance, in addition to creating lasting harm to a taxpayer's financial viability.[8] In this year's report, TAS presents new information that further questions the utility of the NFTL as a collection tool. In our 2012 research study on liens, TAS compares the payment and compliance behavior of a sample of cases representing taxpayers that were the subject of IRS liens against a control sample of similarly delinquent taxpayers without liens. The analysis reveals that over a nine-year period (calendar years 2002-2010), the group of taxpayers without liens paid more on the liabilities, and owed less delinquent taxes overall at the conclusion of the study period than the taxpayers with liens.[9]

Additionally, the study reveals that the taxpayers who had entered into installment agreements during the study period paid significantly more, and owed substantially less delinquent revenue at the conclusion of calendar year 2010 than the taxpayers who had not received an agreement. Further, taxpayers with OICs accepted during the study period owed substantially less at the end of 2010 than those taxpayers with liens.

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

9 *See* TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.

FIGURE 1.3, Comparing Long-Term Compliance (Liens v. Payment Alternatives)



The findings in this report indicate that flexible payment options are not only more effective than liens in assisting the IRS to collect delinquent revenue, but also appear to be significantly more beneficial in breaking the cycle of noncompliance with delinquent taxpayers than is evident in the IRS's lien-filing practices.[10] These studies support the National Taxpayer Advocate's assertion that there is a continued need for the IRS to refine the criteria its collectors use to justify filing NFTLs, and make meaningful adjustments to its lien-filing practices.

Although the new procedures for lien withdrawals have been helpful and productive, TAS is still receiving reports that some IRS employees are not fully aware of the new policies, and tax professionals have found them hard to find on the IRS website. The IRS has just recently updated the IRM material reflecting the new procedures. We believe the IRS should be more proactive in its internal training and external outreach to communicate and support these important changes.

In this report, the National Taxpayer Advocate addresses concerns with IRS lien-filing practices in the Most Serious Problem, *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Liens Filed, the IRS Has Failed to Determine if Its Lien-Filing Practices Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*, and the TAS Research Study, *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior* in Volume 2.

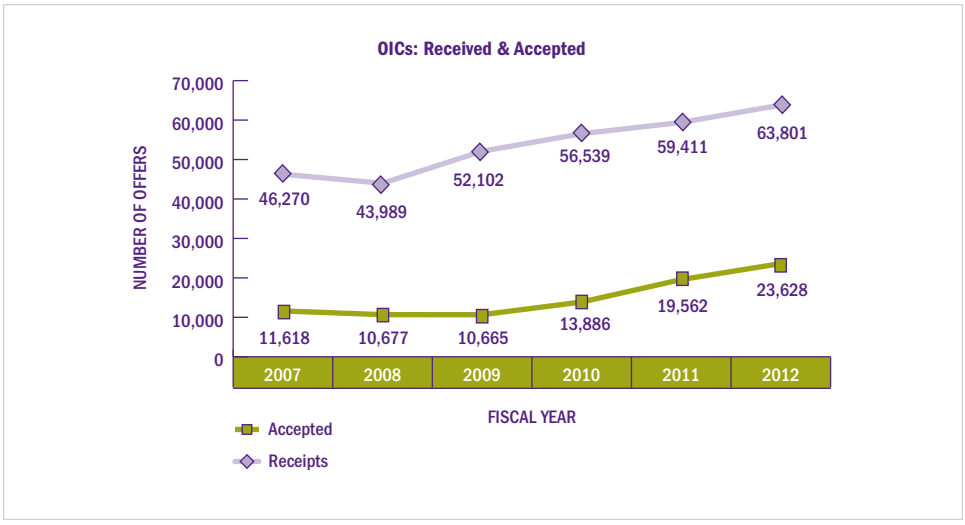
Despite positive changes in IRS policies and procedures, the Offer in Compromise program remains an underutilized payment option for taxpayers who owe back taxes.

The "Fresh Start" initiative introduced into the OIC program a number of positive, reasonable flexibilities that have been lacking for many years. The National Taxpayer Advocate

10 *See* TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.

notes that the IRS has accepted 21 percent more offers in FY 2012 than in FY 2011, and that the actual number of accepted offers has increased by 122 percent compared to FY 2009.[11] In FY 2012, the offer acceptance rate of 38 percent was the highest in many years.[12] During FY 2012, the IRS accepted in compromise $195.7 million, a 27 percent increase over the prior year.[13]

FIGURE 1.4, Offers In Compromise: Receipts & Accepted FY 2007-2012



The positive trends in the OIC program results indicate the "Fresh Start" procedural changes are working as intended. However, the number of taxpayers who have actually been able to benefit from these changes remains surprisingly low. Despite the improving results, access to the OIC program appears to be limited, and consequently the program continues to be underutilized. While OIC receipts have gone up, the nearly 64,000 offers received by the IRS in FY 2012 represents a very small percentage of the delinquent taxpayer population.[14] Although accepted OICs have increased by 122 percent since FY 2009, that increase in FY 2012 represents only approximately 13,000 additional taxpayers.[15]

In March 2012, the Treasury Inspector General for Tax Administration (TIGTA) reported inadequate staffing and increased demand in the OIC program have created inventory

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

12 *Id.*

13 *Id.*

14 IRS, Collection Activity Report, NO-5000-108, *Monthly Report of Offer in Compromise Activity* (Oct. 2012); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

15 IRS, Collection Activity Report, NO-5000-108, *Monthly Report of Offer in Compromise Activity* (FY 2009–2012).

backlogs and processing delays that could affect a significant number of taxpayers.[16] The National Taxpayer Advocate shares these concerns. She has questioned the IRS about the very small number of Collection employees authorized to work OIC cases, especially in light of the high volumes of cases routinely assigned to the Collection Queue inventory, and those systemically reported as uncollectible prior to any personal contact with the IRS.[17] The OIC is an important Collection tool, and is especially effective in resolving difficult cases. Yet very few Revenue Officers are empowered to recommend acceptance of a taxpayer's offer to resolve outstanding tax debts, which would also provide a reasonable path for the taxpayer to return to compliance. Over the past two years, the IRS has made very significant improvements to the OIC program. It would be unfortunate for tax administration if the benefits of these changes were under-realized due to internal limits on the Collection resources available to handle OIC applications.

In this report, the National Taxpayer Advocate discusses missed opportunities for the IRS to use the offer in compromise more effectively in the following Most Serious Problems: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations,* and *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance.* See also the TAS Research Study, *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior* in Volume 2.

The "Fresh Start" increased IRS flexibilities in granting installment agreements; yet, the IRS actually granted fewer of them in FY 2012.

Because the "Fresh Start" initiative introduced new and significantly expanded criteria for "streamlined" installment agreements (SLIAs), the National Taxpayer Advocate is concerned that installment agreements (IAs) approved by the IRS actually *declined* in FY 2012 — by two percent in total, with a corresponding *reduction* in "streamlined" agreements of four percent.[18] The decline in approved agreements affected both individual and business taxpayers.[19] Given the increased flexibilities built into the SLIA process by the "Fresh Start" initiative, the decrease in approved IAs is difficult to explain.

Ironically, in FY 2012, the IRS collected approximately $10.7 billion through IAs – well in excess of what it collected through all other delinquent account treatments *combined.*[20] At the heart of the "Fresh Start" initiative was the recognition that for most collection cases, a simple, well-articulated path to "getting to yes" on a payment solution increases collections

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

17 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

18 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2011 and 2012).

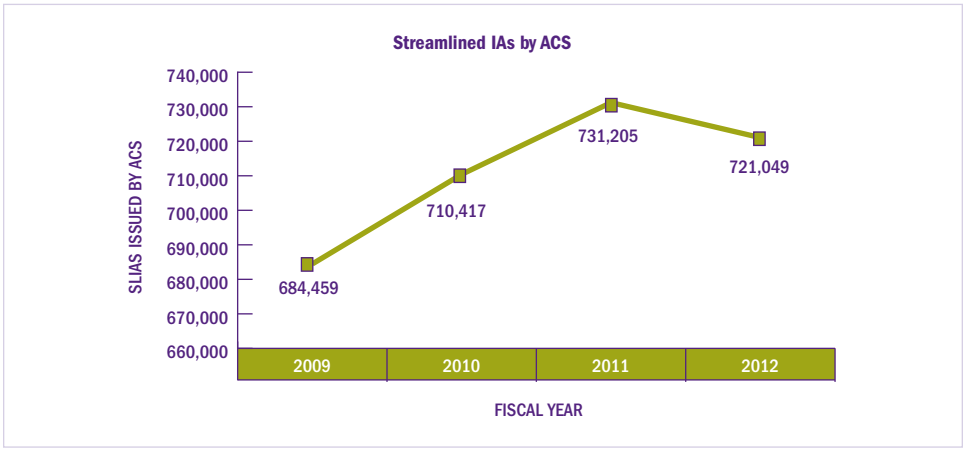
19 *Id.*

20 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2012); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2011 and 2012). In FY 2012, the IRS collected approximately $7.7 billion on taxpayer delinquent accounts (TDAs), excluding IA payments. Note: refund offsets accounted for an additional $3.8 million in collected revenue.

and reduces the stress of uncertainty for taxpayers. Particularly in the early stages of the process, *i.e.,* collection notices and an automated system, a hardline approach to debt collection may be driving taxpayers away from working with the IRS to resolve their debts.

Nevertheless, in our work with the IRS, TAS has identified a number of procedural and cultural issues that may be serving as barriers to the IRS's ability to use the "streamlined" IA tool in the manner intended. The impact of these barriers is particularly evident in the ACS program results for FY 2012, as illustrated below in Figure 1.5.

FIGURE 1.5, Streamlined Installment Agreements Issued by ACS FY 2009–2012



In this report, the National Taxpayer Advocate addresses concerns with cultural and process-related barriers that have negated service delivery in the IRS's collection call centers in the Most Serious Problem, *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload.*

Small business taxpayers have received little relief through the "Fresh Start" initiative.

The positive impact of the "Fresh Start" initiative on small business taxpayers has been negligible. The expanded criteria for "express" IAs have not succeeded in providing more of these taxpayers with access to this very important payment option. In fact, notwithstanding today's difficult economic climate, the numbers of business taxpayers receiving IAs and "express" streamlined agreements have actually *declined* during the past fiscal year by approximately six percent and seven percent, respectively.[21] Installment agreements involving business tax delinquencies continue to account for only a very small portion of IRS installment agreements — three percent of those issued in FY 2012.[22] Further, in FY 2012

21 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2011 and 2012).

22 *Id*. The term "business tax delinquencies" refers to TDAs that reside on the IRS Business Master File (BMF).

the IRS granted agreements to only approximately eight percent of the delinquent business taxpayers eligible to receive them.[23]

The OIC based on effective tax administration (ETA) also continues to be an underutilized collection tool. The ETA OIC provides the IRS with the means to accept from a taxpayer an amount less than the reasonable collection potential in situations where the facts indicate such a resolution would be fair and equitable. Particularly during the current economic downturn, the ETA OIC allows the IRS to consider the circumstances that led to a delinquency and weigh the long-term benefits of allowing an otherwise viable business to survive, by paying less than the amount legally owed, against the government's interest in quickly collecting as much as possible through liquidation of the business assets.

Along with a troubled economy, in recent years the IRS has identified numerous situations involving fraudulent actions of third parties that resulted in substantial employment tax liabilities for otherwise compliant businesses. These taxpayers believed the taxes had been paid in a timely manner, and actually did provide the funds to satisfy the tax obligations to the third parties. Despite these conditions, over the past four years, the IRS has accepted an average of 27 ETA OICs *per year* that were not based on doubt as to collectibility.[24] It is exceptionally unfortunate that a collection tool that could provide much-needed relief to deserving small business taxpayers has been virtually discarded during these very difficult times. The IRS's reluctance to the use the ETA OIC in appropriate situations has been counter-productive, and potentially harmful to the U.S. economy.

In this report, the National Taxpayer Advocate expresses serious concerns that procedural and cultural barriers in the current IRS collecting process have minimized service delivery for small business taxpayers in these Most Serious Problems: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations; Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance;* and *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload.*

The IRS needs to build a service-oriented Collection climate onto the foundation established by the "Fresh Start" initiative.

Prudent use of IRS Collection resources will be a key factor in realizing the benefits of the "Fresh Start" changes. The National Taxpayer Advocate is concerned that the IRS is not using Collection resources in a manner that properly emphasizes personal, "one-stop" service,

23 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2012); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2011 and 2012). As of Sept. 2011, the IRS Collection operation reported 694,036 BMF taxpayer cases in open inventory. During FY 2012, 517,415 BMF taxpayer cases were received. The IRS issued 99,687 BMF IAs during FY 2012.

24 IRS response to TAS information request (Oct. 23, 2012). From FY 2009 through FY 2012, the IRS accepted 108 ETA OICs that were not based on economic hardship. This includes individual as well as business delinquencies. By law, business entities cannot be considered for economic hardship determinations.

effective problem-solving techniques, and the long-term compliance of the affected taxpayers. Collection cases involving complex issues, *e.g.*, determining the viability of a small business struggling with employment tax debt, or accurately evaluating the reasonable collection potential of a self-employed taxpayer, can often benefit from the timely intervention of a local Revenue Officer. With a relatively simple telephone conversation, ACS can often effectively service collection cases involving wage-earners with small balances due. However, the IRS "one-size-fits-all" approach to applying collection resources and treatments to most collection cases does not balance the service and compliance-related needs of many taxpayers with Collection's priorities and objectives.

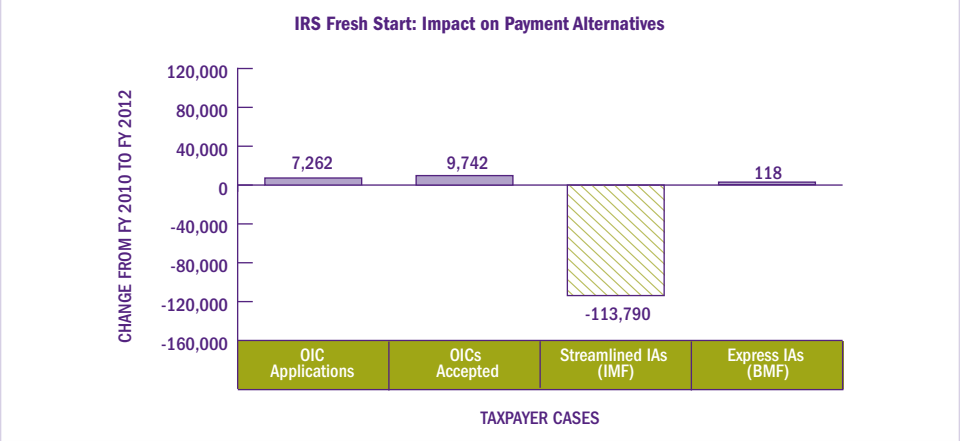
In this report, the National Taxpayer Advocate urges the IRS to reassess and adjust its deployment of collection resources to more effectively balance service delivery and long-term compliance with current program objectives that emphasize case-processing efficiencies. These concerns are addressed in the Most Serious Problems, *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations,* and *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload.* For an additional discussion regarding the National Taxpayer Advocate's efforts to assess the comparative outcomes of IRS Collection case assignment practices, see *Comparing the Impact of Revenue Officers and the Automated Collection System on Future Compliance: A Research Prospectus* in Volume 2.

CONCLUSION

The "Fresh Start" initiative was a "good start"; however, much more emphasis on service delivery is needed to make the "fresh start" a reality for taxpayers.

The National Taxpayer Advocate acknowledges that parts of the "Fresh Start" initiative have delivered positive results for some taxpayers, and could provide relief and assistance to many more who are attempting to regain financial viability. However, as illustrated below in Figure 1.6, relatively few taxpayers have yet to actually experience the benefits of the "Fresh Start" changes, particularly in regard to flexible payment options.

FIGURE 1.6, Offers In Compromise and Installment Agreements Under "Fresh Start"



The IRS needs to expand the scope of the initiative, while removing procedural and cultural barriers that limit taxpayer access to these collection alternatives, in order to maximize the long-term benefits of these important policy changes. In particular, the IRS needs to identify the barriers that deny small business taxpayers the opportunity to resolve tax problems through flexible, realistic payment options, such as installment agreements and offers in compromise.[25] Further, the IRS needs to better promote the "Fresh Start" initiative in its internal Collection training and external communication strategies, as well as allocate adequate resources to its functions to ensure the benefits of the initiative are real and sustainable.

The IRS is on the cusp of a significant change in leadership, as Commissioner Doug Shulman has departed, and a new Commissioner will be appointed. Historically, changes in IRS leadership have often resulted in the unforeseen consequence of pro-taxpayer developments, such as the "Fresh Start" initiative, losing focus and momentum. Consequently, the cultural barriers within the Service — Collection, in particular — soon work to dismantle and reverse any positive changes that have not yet firmly taken root. It is very important to note that the "Fresh Start" initiative did not "fix" Collection. Rather, it produced a number of meaningful policy changes that can serve as a foundation for further improvements. The National Taxpayer Advocate sincerely urges the IRS to build on this foundation by creating an environment that actually embraces service delivery as a critically important component of effective tax collection.

25 For more information on the potential long-term benefits of the IRS's flexible payment options, see the TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.

MSP #20 The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations

RESPONSIBLE OFFICIALS

Steven T. Miller, Deputy Commissioner, Services and Enforcement
Faris Fink, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

An imbalanced focus within the IRS Collection operation on automation, centralization, and enforcement has undermined the service and compliance-oriented components of the field-based Revenue Officer job. The IRS does little to identify segments of the taxpayer population that would benefit from timely, face-to-face contacts with skilled collectors, specifically trained to address their problems in a service-oriented manner. Particularly with tax debts involving small business taxpayers, the Revenue Officer's skill set should be recognized as critical to case resolutions that are in the best interests of the taxpayers and the United States.

In recent years, the IRS has reduced the role of field contacts in resolving most types of collection cases, and adopted a model for Revenue Officers that emphasizes the use of highly technical enforcement actions in cases that are considered "complex." However, the IRS's simple definition of "case complexity" ignores the characteristics and needs of different types of taxpayers. Small businesses with tax problems represent a particular group of taxpayers with similar needs, which are best met by a local IRS presence. While the IRS does not consider most employment tax delinquencies as "complex," the Automated Collection System (ACS) has not been successful in servicing this segment of the taxpayer population:

- In fiscal year (FY) 2012, the ACS collected only *11.5 percent* of the dollar value of the employment tax cases received.[1]
- Of the employment tax cases routed through the automated system in FY 2012, *62 percent left ACS as unresolved accounts.*[2]
- In FY 2012, the ACS *transferred* to the Collection Queue or the Collection Field operation approximately *7.3 times* the number of delinquent employment tax dollars that it collected.[3]

Nevertheless, the IRS continues to migrate employment tax cases to ACS, even though this practice has never been supported by Collection results.

1 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

2 *Id.* "Unresolved" accounts include those transferred to the Queue and Collection Field function (CFf), along with cases closed as "deferred" and systemically reported as uncollectible.

3 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

Although the IRS emphasizes the use of "complex" collection tools in resolving "complex" field cases, most Revenue Officers are not authorized to use all the available tools. Despite the impact of a troubled economy, the use of important collection tools, such as installment agreements, offers in compromise, and lien withdrawals to negotiate "win-win" resolutions in small business cases are conspicuously rare. At the conclusion of FY 2012,

- The IRS reported approximately 4.5 million taxpayer accounts, valued at approximately $139 billion, in either the Collection Queue or the "currently not collectible" (CNC) inventory.[4]
- Only 3,001 offers in compromise (OICs) had been recommended for acceptance by Revenue Officers, which recovered only $68.3 million in delinquent revenue, or 0.05 percent of the amount in the Collection Queue and CNC inventories.[5]
- *Revenue Officers issued less than one non-streamlined installment agreement per month for cases reported by the IRS on the Business Master File (BMF), and approximately one BMF streamlined agreement per year.*[6]

The IRS's use of the Collection Queue masks the ineffectiveness of Collection's inventory delivery system, and distorts the perceived delivery of taxpayer service in many Collection cases. Further, the use of the Queue appears to have heavily contributed to the indifference of the IRS to the aging of collection accounts, and to the negative outcomes that the delays in case processing have for taxpayers and the IRS's business results. In addition, traditional IRS measures are not adequate to assess the benefits of the Collection Field operation, particularly in the areas of revenue protection and compliance. Prudent tax administration and debt collection require that the IRS consider issues beyond superficial case processing efficiencies. Particularly in working with small business taxpayers, the IRS cannot achieve important objectives such as revenue protection and long-term compliance without the service-oriented "field presence" the IRS Revenue Officer can provide.

ANALYSIS OF PROBLEM

With the increasing use of ACS to address the collection workload, the IRS has struggled to determine the best use of Revenue Officers.

Revenue Officers are the "most skilled and highly paid" debt collectors in the IRS Collection Field function (CFf).[7] In theory, their assigned cases involve high-risk, complex accounts that require intervention by a Revenue Officer for proper resolution. Accordingly, Revenue

4 IRS, Collection Activity Reports, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012), NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Oct. 2012).

5 IRS, Collection Activity Report, NO-5000-108, *Report of Offer in Compromise Activity* (Oct. 2012).

6 Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2012). In FY 2012, the IRS CFf granted 38,517 installment agreements on BMF accounts. Of these, 3,806 were "streamlined" agreements. Per an IRS response to a TAS information request (Sept. 13, 2012), the IRS had 3,733 Revenue Officers working collection inventories as of September 2011.

7 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design - Final Report* 10 (June 6, 2006).

Officers are empowered with a wide range of powerful collection tools, along with the ability to conduct personal field contacts with taxpayers at their homes or businesses.

Since the implementation of ACS, however, the role and value of the Revenue Officer within the overall collecting process have been studied, questioned, and debated.[8] Particularly in recent years, budgetary concerns have led the IRS to attempt to improve efficiencies through increased use of automated enforcement tools generated by bulk-processing operations, *e.g.,* ACS call sites. Noting that CFf resources are the "most costly," one key recommendation in a recent, comprehensive study of the collecting process identified a need to "right-size" the Collection Field function.[9]

A common theme in the IRS's most recent effort to determine the proper role of the Revenue Officer centers around the concept that field-based Collection work should focus on "complex and higher value cases."[10] The IRS has noted that Revenue Officers play a special role as the "final stop" in the overall collecting process, and can constitute an "elite corps of collection professionals" with the skills and authority to resolve cases that cannot be handled through notice and telephone contacts.[11] Current IRS thinking holds that Revenue Officers should only work the "most critical, complex, technical cases," with all other collection cases resolved earlier in the process through notices and taxpayer interactions with ACS.[12]

The IRS's simple definition of "case complexity" ignores the characteristics and needs of different types of taxpayers.

While the concept of "case complexity" is prominent in virtually all discussions involving the proper use of Revenue Officers, the IRS's current model for determining the complexity of collection cases is actually a throwback to the traditional IRS mindset, which bases the projected complexity of a case on the dollar value of the delinquent account.

The CFf's methods of delivering inventory are based in part on IRS studies which determined that cases taking relatively few direct hours for a Revenue Officer to resolve are not complex, *i.e.,* "a relatively rapid closure suggests the Revenue Officer may not have used the time to apply advanced technical skills."[13] Further, delinquencies involving smaller balances due are generally not considered complex.[14] This model contends that cases requiring Revenue Officer skills should routinely involve the use of technically complex enforcement actions, *e.g.,* seizures, suit recommendations, nominee/alter ego liens, complex financial

8 The ACS, a group of automated telephone call centers, was implemented by the IRS in 1984 to modernize and centralize the collecting work needed for accounts that are not resolved in the collection notice process. Most Taxpayer Delinquent Accounts (TDAs) are assigned to ACS, at least initially, for resolution.

9 IRS, *Collection Process Study* 163-66 (Sept. 30, 2010).

10 *Id*. at 163 (Sept. 30, 2010).

11 IRS, *Future Field Collection Design, Current State Design* 12, 34 (Nov. 10, 2005).

12 *Id*. at 5 (Nov. 10, 2005); IRS, *Collection Process Study* 163-66 (Sept. 30, 2010).

13 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design - Final Report* 12 (June 6, 2006).

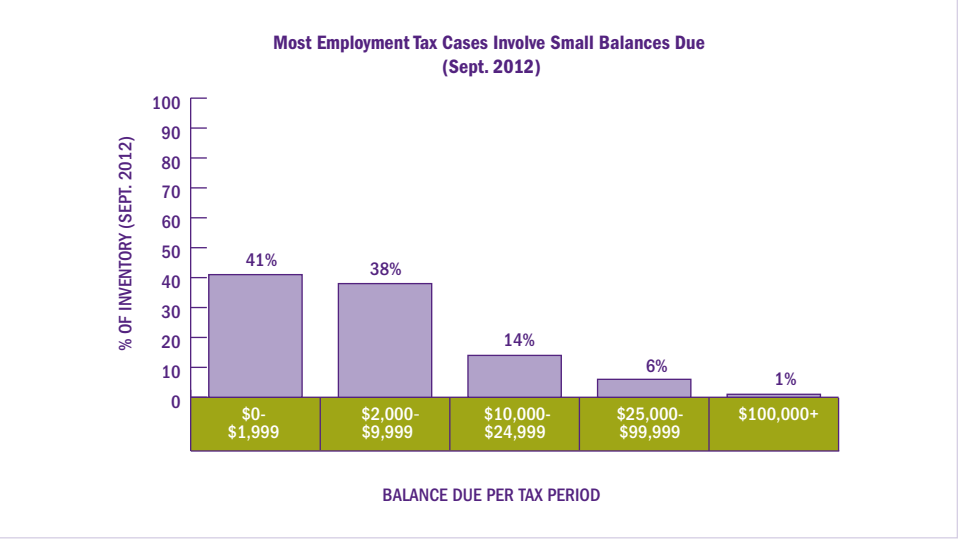
14 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design - Final Report* 13 (June 6, 2006).

analysis, and complex use of levies and liens.[15] The IRS assumes that assigning Revenue Officers to handle relatively low-dollar delinquencies that are quickly collected with only a modest investment of time represents an inefficient and unproductive use of CFf resources.[16] The future vision for the Revenue Officer involves complex investigations, complex financial analysis, and routine use of highly technical enforcement tools.[17]

Most employment tax delinquencies are not considered "complex"; yet, ACS has not been successful in servicing this segment of the taxpayer population.

The majority of employment tax delinquencies originate as relatively small-dollar accounts.[18] At the end of FY 2012, approximately 79 percent of the taxpayer delinquent accounts (TDAs) involving employment taxes had balances due of less than $10,000, and 41 percent of these balances were less than $2,000.[19] Generally, the IRS does not consider these cases "complex," and therefore initially assigns them to the automated system.[20]

FIGURE 1.20.1, Balances Due in Employment Tax Cases



15 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design - Appendices* 13 (May 26, 2006).

16 *Id*. at 18 (May 26, 2006). "Rather, as noted above, the IPT (Integrated Project Team) sought to select the type of cases that the ENTITY extract data review indicated might be prone to closure with relatively few direct hours applied by the RO. The thought was such cases might not require the application of RO technical skills or field presence. In addition, the team felt that these types of cases potentially could be cases more appropriately worked by another treatment stream."

17 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design - Final Report* 29 (June 6, 2006).

18 In this report, the term "employment tax" is used for taxes reported on Form 941, *Employer's Quarterly Federal Tax Return*, and Form 944, *Employer's Annual Federal Tax Return*.

19 IRS, Collection Activity Report, NO-5000-242, *Type Assessment Cumulative Report* (Oct. 2012).

20 IRS response to TAS information request (Sept. 13, 2012). *See also* IRM 5.1.20.2.3, *Collection Inventory Management – Rules* (May 27, 2008).

Looking at all cases reported on the IRS Business Master File (BMF), in FY 2012 the IRS routed delinquent BMF tax accounts valued at approximately $3.5 billion to ACS,[21] but the system only collected about $394 million, or roughly 11 percent of the dollar value of the cases.[22] Of the BMF tax cases that passed through the ACS system in FY 2012, 60 percent, or $2.1 billion in delinquent revenue, were transferred to the Queue.[23] An additional 12 percent of these cases, totaling approximately $426 million, were ultimately transferred to the CFf.[24] Approximately six percent of these accounts, or $201 million, were systemically reported as uncollectible.[25] In summary, of the BMF tax dollars routed through the ACS system in FY 2012, *78 percent left ACS as unresolved accounts.*[26]

In FY 2012, although the IRS routed 525,425 BMF taxpayer cases to ACS, the unit issued only 31,070 installment agreements on BMF accounts.[27] ACS will not discuss an installment agreement, or even obtain a Collection Information Statement, when contacted by a business taxpayer if the delinquency involves unfiled returns.[28] In fact, ACS assistors are not trained to secure and analyze business-related financial statements, and are not authorized to grant non-streamlined installment agreements on employment tax cases.[29] Figure 1.20.2 below illustrates the inefficiency of ACS in handling business tax delinquencies.

21 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.* In FY 2012, ACS reported $200,511,110 of BMF TDAs as currently not collectible with a closing code indicating the cases were "shelved" as low priority accounts that did not warrant the investment of Collection resources.

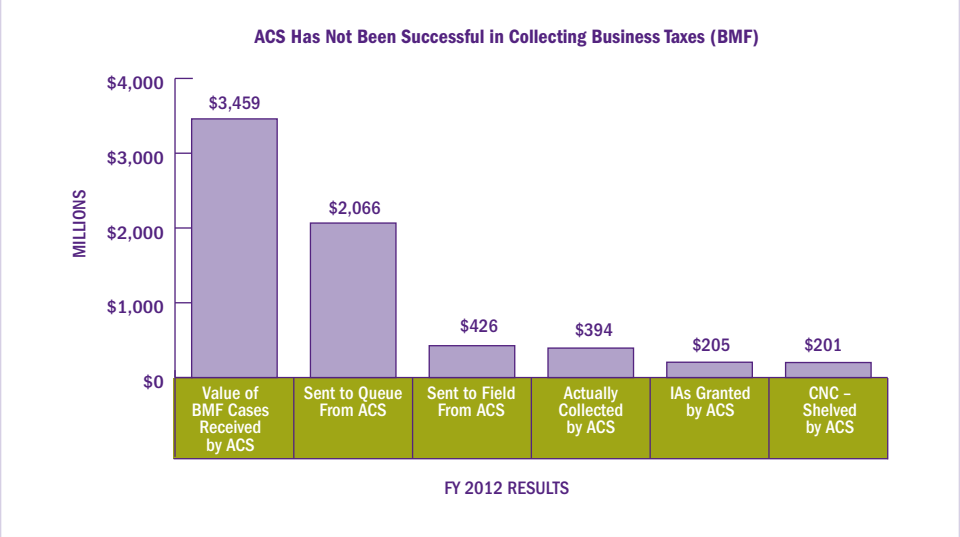
26 *Id.*

27 IRS, Collection Activity Reports, NO-5000-6, *Installment Agreement Reports* (Oct. 2012), NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012). The dollar value of the BMF accounts involving installment agreements issued by ACS in FY 2012 was approximately $205 million.

28 IRM 5.19.1, *Balance Due* (Nov. 3, 2010).

29 IRS response to TAS information request (Sept. 13, 2012).

FIGURE 1.20.2, ACS Business Collection Results for FY 2012



These results indicate that although the IRS has determined the majority of employment tax cases are not complex enough to warrant immediate assignment to Revenue Officers, assigning these accounts to ACS is ineffective. Overall in FY 2012, the IRS collected approximately $1.7 billion in delinquent employment taxes, but reported $5 billion as uncollectible — a *net loss* of $3.3 billion.[30] Nevertheless, recent decisions to "right-size" the CFf will force approximately 80 percent of delinquent employment tax cases through ACS before considering them worthy of field assignment.[31]

"Time is Money": IRS failure to timely address emerging employment tax problems leads to larger liabilities downstream.

IRS focus group participants have indicated that the main reason small business taxpayers do not pay their payroll taxes is because "they do not see the immediate consequences of noncompliance."[32] When participants were asked how the IRS could help these taxpayers, the number one strategy they recommended was "the need for the IRS to react faster."[33] Participants stated, "The main problem is that many taxpayers are buried too deep by the time the IRS gets involved."[34]

30 IRS, Collection Activity Reports, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012), NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2012).

31 IRS response to TAS information request (Sept. 13, 2012); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012). Based on open TDA inventory as of Sept. 2012, the change in case routing would result in the assignment of approximately 80 percent of all employment tax cases to ACS.

32 IRS, SB/SE Research, *Your Clients and the Economy – How Can the IRS Help*, 4 (Jan. 2010).

33 *Id.*

34 *Id.*

Unfortunately, "reacting faster" from the taxpayer's perspective is not a key component of the IRS collection strategy, which places very little emphasis on pre-delinquency education and intervention. The use of Federal Tax Deposit (FTD) Alerts and other field contacts on relatively small balance-due employment tax accounts is rare.[35] In FY 2012, BMF taxpayer cases routed to the CFf had, on average, approximately seven tax delinquency accounts (TDAs) per taxpayer.[36] Given that many of these taxpayers are accumulating additional tax debts, most of these cases are likely to include at least one additional quarterly employment tax liability that the IRS is trying to resolve by sending notices, along with unpaid FTDs in the current quarter.[37]

Thus, it appears that the typical BMF case that the IRS believes warrants a field contact has already accumulated over two years of quarterly employment tax delinquencies before the IRS even attempts a face-to-face contact. As the National Taxpayer Advocate noted in the 2010 Annual Report to Congress, by this time, unfortunately, many of these small business taxpayers are already "buried too deep."[38]

The IRS's "complexity" model has reversed case assignment practices implemented through earlier "Collection Reengineering" efforts.

A key component of the IRS Restructuring and Reform Act of 1998 was a realignment into units serving particular groups of taxpayers with similar needs.[39] In June 2001, the IRS approved and implemented a number of recommendations designed to meet this service objective for small business taxpayers.

The primary focus of the Collection Reengineering, Phase I recommendations was to make relatively fresh employment tax delinquencies the top priority for CFf case assignments.[40] The IRS determined that early intervention by Revenue Officers in these emerging cases would not only increase the dollars collected but also would minimize the substantial amount of revenue lost to delays built into the collecting process. At the time, the Collection Reengineering team estimated that approximately $2.8 billion per year in otherwise lost revenue could be "protected" through early intervention by Revenue Officers.[41]

35 IRM 5.7.1.1 (May 12, 2012). The FTD Alert process identifies, at an early stage (*i.e.*, before the return is due), taxpayers who have fallen behind in their deposits. FTD Alerts determine an employer's compliance with employment tax deposit requirements for the quarter of Alert issuance, and for subsequent quarters until the taxpayer is brought into full compliance.

36 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 2012).

37 IRS, SB/SE Research, *Evaluating the Effect of Time in Inventory on the Compliance of Employment Tax Cases* 27 (Mar. 2010). This study concluded, "Business taxpayers with employment tax cases sitting in the Queue, where there is no collection activity, by and large do not appear to independently take steps to resolve their delinquent accounts."

38 National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).

39 Pub L. No. 105-206, 112 Stat. 685 (1998).

40 IRS, *SB/SE Collections Quick Hits, Approach and Preliminary Findings* 5 (Mar. 27, 2001). This report stated, "We believe that dramatic collection improvements can be achieved through modification of IDS priorities to emphasize BMF trust fund cases in the field."

41 *Id. at* I-8 (June 21, 2001).

(As noted earlier: in FY 2012, the IRS reported approximately $5 billion of employment tax delinquencies as uncollectible.)[42]

While acknowledging that ACS can collect a portion of the employment tax accounts, the Collection Reengineering project team stressed that the system was not designed to effectively address compliance, in either the short or long term, on business accounts.[43] Additionally, ACS employees do not have the training or experience to conduct the complex financial analysis required to determine the most appropriate payment options for in-business taxpayers with emerging tax problems.[44]

The project team also emphasized that early intervention by Revenue Officers would improve taxpayer service and satisfaction by addressing the tax problems at a point when taxpayers are more likely to resolve the delinquencies without declaring bankruptcy or ceasing business operations.[45] On the other hand, the team projected that removing all but the smallest employment tax cases from ACS would allow the call sites to devote more time and attention to the accounts they are better designed to service — relatively simple individual income tax delinquencies.

Although early results of the Collection Reengineering effort indicated substantial improvements, the IRS soon returned to a "complexity" model.

In May 2004, the IRS conducted a follow-up analysis of the impact of the Collection Reengineering recommendations and determined that:

- Total dollars collected and full paid accounts increased in both the CFf and ACS;
- Cases reported as uncollectible decreased; and
- Dollars collected in employment tax cases increased.[46]

42 IRS, Collection Activity Report, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Oct. 2012).

43 IRS, *SB/SE Collections Quick Hits, Approach and Preliminary Findings* 24 (Mar. 27, 2001). This report noted, "Concentration of 941 cases in ACS leaves many 941 cases unresolved, while keeping ACS from working its IMF caseload."

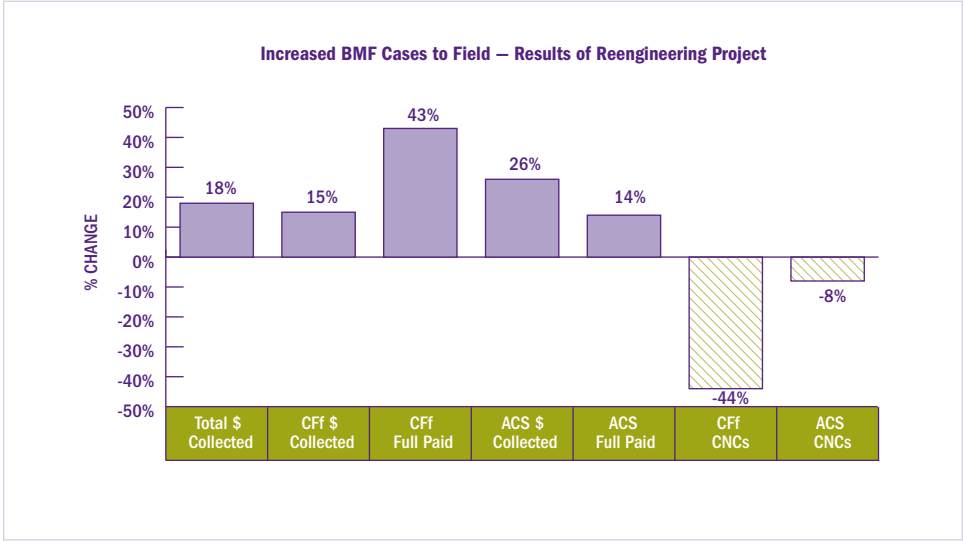
44 IRS response to TAS information request (Sept. 13, 2012).

45 IRS, *SB/SE Collections Quick Hits, Approach and Preliminary Findings* 4 (Mar. 27, 2001). This report noted, "Current system does not promote 'Fairness to Each Taxpayer' – Delayed IRS intervention makes it difficult for delinquent taxpayers to resolve tax problems while continuing in business... Aged Trust Fund accounts with multiple delinquent periods usually require enforcement action to resolve because taxpayers do not have the financial capability to comply voluntarily. Interactions with taxpayers are much more confrontational."

46 IRS, *Collection Reengineering – Phase I, Interim Report* 8-29 (May 14, 2004). This analysis compared collection data collected prior to Collection Reengineering (FY 2001) with data after the implementation of Collection Reengineering (FY 2002). The study also compared the six-month period post-Phase I implementation, October 2001 through March 2002, to the comparable period in the following fiscal year, October 2002 through March 2003. The analysis indicated that total dollars collected increased by 18 percent. The age and average cycle times of employment tax cases in the CFf decreased. Full paid dispositions in the CFf increased by 43 percent, and cases reported as uncollectible decreased 44 percent. Dollars collected in the CFf increased by 15 percent overall, and 23 percent for employment tax cases.

In addition, ACS dispositions increased, with a 49 percent increase in installment agreements, and a substantial gain in ACS dollars collected on accounts involving tax delinquencies on individuals.[47]

FIGURE 1.20.3, Collection Reengineering Results In Business Cases



Although this analysis indicated the Collection Reengineering changes were delivering the intended results, the IRS astonishingly concluded in a subsequent study that CFf resources used in this manner were not efficient. In 2006, the Future Field Collection Design (FFCD) project determined that relatively small-dollar employment tax cases could be resolved by ACS and did not meet the "complexity" threshold for Revenue Officer assignment.[48] Yet, the FFCD report acknowledged that the project *did not conduct any analysis of the effectiveness of ACS* in handling these cases.[49]

In 2010, the IRS Collection Process Study (CPS) adopted the FFCD complexity model, and recommended that over 90 percent of all new employment tax cases be handled, at least

47 *Id.* The analysis indicated that ACS dispositions increased by 20 percent, with a 14 percent increase in full paid accounts. Additionally, installment agreements issued by ACS increased by 49 percent, while ACS cases reported as uncollectible decreased by eight percent. Dollars collected by ACS increased 26 percent overall, and 42 percent on accounts involving individual tax delinquencies.

48 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design – Final Report* 18 (May 26, 2006). "One potential factor contributing to this high percentage of cases with few hours applied and not needing to be worked by Revenue Officers is that most of these cases did not have the benefit of upstream ACS processing. Since the majority of cases reviewed were from the 100 risk code series, they met the ACS 'bypass' criteria. If ACS had had an opportunity to work these cases, some portion of them may have been closed and not assigned to the field. This demonstrates the need and, therefore, our recommendation to redesign and utilize ACS to the greatest extent possible to work high priority/high risk cases." *Id.*

49 *Id. at* 2 (May 26, 2006). "The FFCD project team did not conduct any analysis of Automated Collection System (ACS). However, the team believes that a redesign of ACS's upfront collection stream processes could potentially provide a more cost-effective solution toward closing the less complex work that is now in the Queue or in the inventory of the ROs. A comprehensive workload study should include a thorough review of what changes in ACS operations, processes, staffing, and management would have to take place to ensure success in working a different workload."

initially, by ACS.[50] The IRS implemented a modified version of the CPS recommendation in FY 2012.[51] Although the FFCD and CPS studies both recommended that the IRS conduct further, comprehensive workload studies to support organizational changes in assignments, no such study has been completed.[52] Further, the National Taxpayer Advocate is not aware of any study that has concluded that ACS has been effective in fully resolving employment tax cases.[53] Nevertheless, the migration of these cases to ACS continues.

IRS program results do not appear to support these decisions. In FY 2012, the IRS issued 82 percent of the new BMF taxpayer cases to ACS; overall, BMF taxpayer case receipts in ACS increased by 17 percent over the same period in FY 2011.[54] This increase reflects the most recent emphasis on routing these cases through ACS prior to any involvement by the CFf.[55] At the same time, however, the delinquent dollars collected on BMF tax accounts by the IRS decreased by 14 percent — over $378 million.[56] Overall, full paid employment tax modules declined by 20 percent.[57] Dollars collected by ACS on employment tax accounts declined by 16 percent, a decrease of approximately $47 million, and the number of full paid employment tax modules collected by ACS decreased by 18 percent.[58] Further, the number of BMF cases transferred from ACS to the Collection Queue in FY 2012 has increased by 57 percent over the FY 2006 level.[59]

50 IRS, *Collection Process Study* 165 (Sept. 30, 2010); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

51 IRS response to TAS information request (Sept. 13, 2012).

52 *Id*.

53 IRS, Pub. 3744, *IRS Strategic Plan* 30 (Apr. 2009). A key element of the IRS Strategic Plan is an objective to use data and research across the organization to make informed decisions and allocate resources. However, decisions made over the past decade to migrate employment tax cases to ACS do not appear to be data driven.

54 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012);

55 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2011 and Oct. 2012).

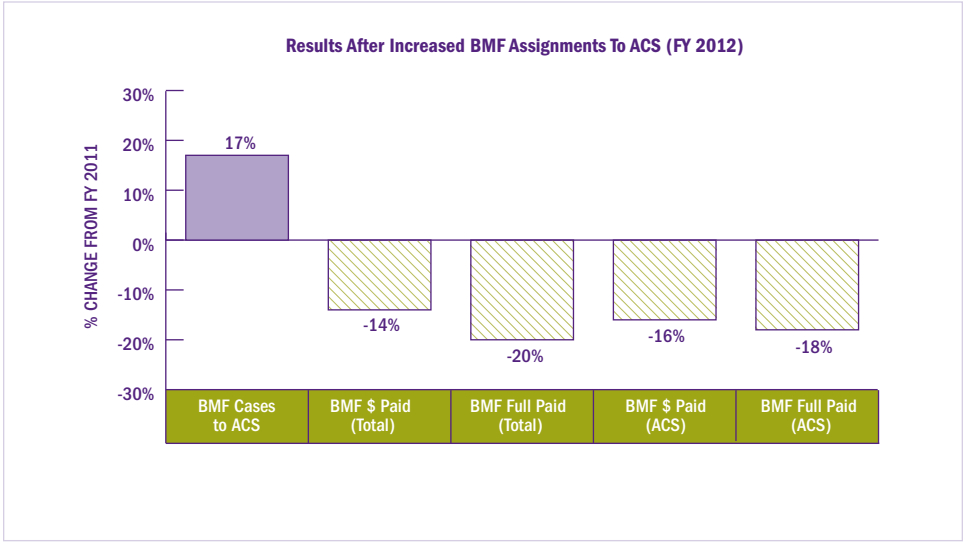
56 *Id*.

57 *Id*.

58 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2011 and Oct. 2012).

59 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2006 - 2012).

FIGURE 1.20.4, Increased Business Case Movement to ACS



Despite the IRS's emphasis on the routine use of "complex" collection tools in resolving "complex" field cases, most Revenue Officers are not authorized to use all the available tools.

Ironically, although it appears that the IRS model for "complex" Collection cases presumes they are difficult to resolve without highly technical collection tools, two valuable tools are unavailable to most Revenue Officers and highly underutilized by the IRS. One of these tools is the offer in compromise (OIC), which less than four percent of Revenue Officers are authorized to recommend that the IRS accept.[60] By design, the OIC allows the IRS to resolve debts for less than the full amount owed, conditioned on the requirement that the taxpayer remain in compliance for the following five years.[61] Under IRS policy, the OIC is a legitimate alternative to reporting an account as uncollectible or resolving it through a lengthy installment agreement.[62]

The current IRS collection inventory delivery system routinely sends the CFf aged cases with multiple delinquent tax periods, *i.e.*, complex cases that are difficult to collect. At the conclusion of FY 2012,

- The Collection Queue contained approximately $63 billion in delinquent accounts, an increase of 132 percent since FY 2006;

60 IRS response to TAS information request (Aug. 14, 2012). As of June 2012, the IRS reported 3,459 Revenue Officers working collection inventories. However, only 129 Revenue Officers were designated as Offer Specialists, who are the only Revenue Officers authorized to investigate OIC applications and make a recommendation to accept a taxpayer's offer.

61 IRM 5.8.1.1.1, *Definition* (Sept. 23, 2008).

62 IRM 5.8.1.1.3, *Policy* (Mar. 16, 2010).

- Another 174,057 taxpayer accounts were actively assigned to the CFf at that time;[63]
- Yet in FY 2012, only 3,001 OICs recovering $68.3 million in delinquent revenue had been recommended for acceptance by Revenue Officers.[64]

These data indicate that although the number of cases that appear tailor-made for offers in compromise is very high, the number of offers recommended for acceptance by the CFf is incredibly low. Still, the IRS has empowered very few Revenue Officers to recommend the acceptance of offers, and only a small percentage of Revenue Officers have the OIC in their toolkit.

Similarly, relatively few Collection employees are empowered to approve and issue lien withdrawals.[65] Although all Revenue Officers at the journey level and above can file Notices of Federal Tax Lien without managerial approval, they do not have similar authority for withdrawing liens.[66] In fact, not even Revenue Officer group managers have this authority. Lien withdrawals must be approved by certain managers in the SB/SE Technical Services operation.[67] In FY 2012, the IRS approved only 12,004 lien withdrawals.[68] Here again, we see a valuable tool that could improve both collection and service to taxpayers, but is not part of the Revenue Officer toolkit. In addition, these restrictions create a significant bottleneck in processing lien withdrawal certificates, which in turn may harm taxpayers.[69]

Despite the impact of a troubled economy, the use of important collection tools such as installment agreements, offers in compromise, and lien withdrawals to negotiate "win-win" resolutions in small business cases is conspicuously rare.

The CFf is the only component of the IRS Collection operation whose employees are trained and authorized to work with small business taxpayers in establishing installment agreements that do not meet "streamlined" criteria, *i.e.,* those that require analysis of the

63 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

64 IRS, Collection Activity Report, NO-5000-108, *Report of Offer in Compromise Activity* (Oct. 2012).

65 IRS response to TAS information request (Aug. 14, 2012). The IRS reports that only approximately 80 Collection employees are authorized to approve requests for lien withdrawals.

66 IRM 1.2.44.5, *Delegation Order 5-4 (Rev. 2)* (May 11, 2012).

67 *Id*.

68 IRS, Collection Activity Report, NO-5000-25, *Liens Report* (Oct. 2012).

69 For an in-depth discussion of the National Taxpayer Advocate's concerns about IRS lien filing and lien withdrawal policies, see *Although the IRS "Fresh Start" Initiative Has Reduced The Number Of Liens Filed, The IRS Has Failed To Determine If Its Lien-Filing Policies Are Clearly Supported By Either Increased Taxpayer Compliance Or Revenue, infra/supra. See also* National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*), vol. 2, 1-18 (Research Study: *The IRS's Use of Notices of Federal Tax Lien*); National Taxpayer Advocate 2010 Annual Report to Congress 302-10 (Status Update: *The IRS Has Been Slow to Address the Adverse Impact of its Lien-Filing Policies on Taxpayers and Future Tax Compliance*), 89-100 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*),91-112 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

taxpayer's financial situation to determine an appropriate payment schedule.[70] *Yet in FY 2012, Revenue Officers issued less than one non-streamlined installment agreement per month on BMF accounts, and approximately one BMF streamlined agreement per year.*[71]

Since 2008, the impact of the struggling economy on small businesses, along with high rates of unemployment, have been headline news on a daily basis. Within this environment, the IRS should be placing more emphasis on identifying and working with small businesses that could potentially survive with the assistance of flexible payment options to resolve their past due taxes. In this manner, these businesses could continue to contribute to the economic recovery and avoid adding numbers to the already high unemployment rate. Nevertheless, the CFf continues to underutilize flexible payment options and lien withdrawals in handling small business cases.

The IRS's use of the Collection Queue masks the ineffectiveness of Collection's inventory delivery system, and distorts the perceived delivery of taxpayer service in many Collection cases.

As the National Taxpayer Advocate discussed in the 2010 Annual Report to Congress, the existence of the Collection Queue has created a "numbing effect" by masking the ineffectiveness of the current collection strategy.[72] Rather than serving as a temporary stop on the "assembly line" for cases requiring assignment to the CFf, the Queue has become an institutionalized repository for cases the IRS has failed to resolve. Further, the use of the Queue appears to have heavily contributed to the indifference of the IRS to the aging of collection accounts, and to the negative outcomes that the delays in case processing have for taxpayers and the IRS's business results.

The Collection Queue's inventory of taxpayer delinquent accounts has increased by 58 percent since FY 2006.[73] At the end of FY 2012, the Queue inventory contained approximately 1.1 million taxpayer accounts, involving 3.9 million TDA modules with delinquencies of approximately $63.1 billion, an increase of 132 percent since FY 2006.[74] In FY 2012, 65 percent of the TDA modules "resolved" in the Queue were reported as uncollectible.[75] These uncollectible TDAs accounted for $6.2 billion, which was 102 percent of all TDA dollars collected by ACS and the Collection Field function *combined*.[76] Further, 35 percent of the

70 IRS response to TAS information request (Sept. 7, 2012). Business-related "Express" installment agreements do not require the analysis of a collection information statement, but are limited to taxpayers who owe less than $25,000, and a payment schedule that cannot exceed 24 months.

71 Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2012). In FY 2012, the IRS CFf granted 38,517 installment agreements on BMF accounts. Of these, 3,806 were "streamlined" agreements. Per an IRS response to a TAS information request (Sept. 13, 2012), the IRS had 3,733 Revenue Officers working collection inventories as of September 2011.

72 National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 69 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).

73 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 2012).

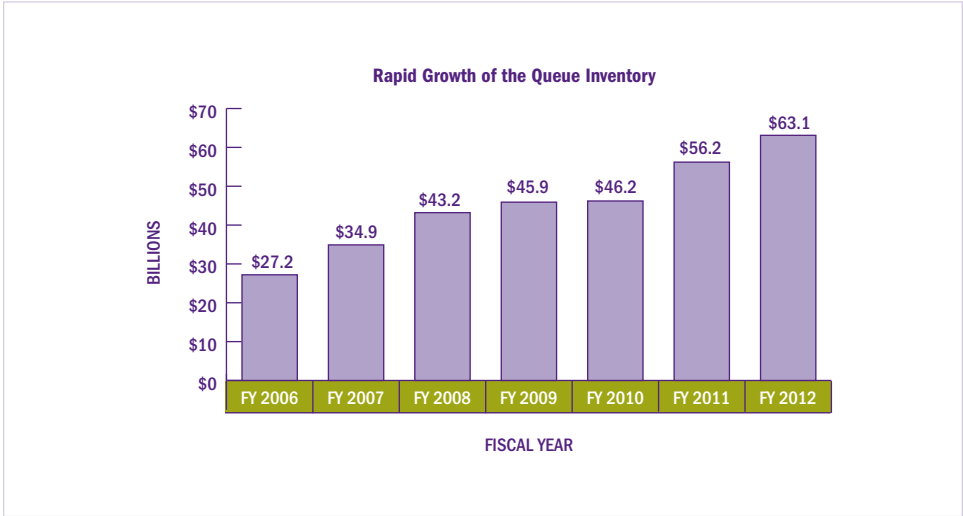
74 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 2006 and Oct. 2012).

75 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 2012). In FY 2012, 1,101,649 TDAs were reported as closed while assigned to the Queue.

76 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 2012).

TDAs that left the Queue in FY 2012 were *returned to ACS*.[77] Only 25 percent of cases leaving the Queue were actually assigned to the CFf.[78]

FIGURE 1.20.5, Growth of Collection Queue Inventory



The IRS perceives the Queue as necessary to manage its excessively large collection workload. However, the existence of the Queue mitigates the need for the IRS to routinely evaluate and revise its case creation practices, make timely, effective contacts on self-reported tax delinquencies, and emphasize "one-stop service" in most collection contacts.

Traditional IRS measures are not adequate to assess the benefits of the Collection Field operation, particularly in the areas of revenue protection and compliance.

The Future Field Collection Design study recommended that the IRS establish a new measure for "return on investment" involving Revenue Officers.[79] Generally, most discussions of this issue involve comparisons using traditional collection measures, such as dollars collected per staff year, case dispositions per staff year, and time the case has been worked by a particular function, *i.e.,* cycle time.[80] Using these measures, the "return on investment" for resources allocated to ACS appears to be substantially higher than for those applied to the CFf.

It is appropriate for the IRS Collection operation to be concerned with increasing the recovery of delinquent revenue, *i.e.* "dollars collected," but this measure must be viewed

77 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 2012).

78 *Id*. In FY 2012, 994,707 TDAs were transferred from the Queue to ACS; 701,933 were transferred to the CFf.

79 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design – Final Report* 3 (May 26, 2006).

80 IRS, *Collection Process Study, Appendix C: Metrics and Measures* 2 (Sept. 30, 2010). In this study's recommendations, "return on investment" is defined as "Dollars Collected/Actual FTEs." The term FTE stands for "full time equivalent" of a staff year.

within a proper context. An equally important metric for any collection operation involves the objective of reducing lost revenue, or "revenue protection." In FY 2012, while the IRS collected approximately $7 billion on TDA accounts, it also reported $30.6 billion as "currently not collectible."[81] At the conclusion of FY 2012, approximately 3.4 million taxpayer accounts representing $76.3 billion were in the CNC inventory.[82]

Within the IRS's current collection strategy, the high volumes of cases reported as CNC, as well as those transferred to the Collection Queue, generally passed through ACS without productive resolution. IRS data indicate that ACS may be effective at quickly resolving accounts that are relatively easy to collect, but never collects substantial portions of its accounts receivable. Yet traditionally, IRS measures appear to disregard this lost revenue when comparing the return on investment of Collection treatments.

Further, the IRS lacks valid measures for the impact of its Collection programs on voluntary compliance — a shortcoming noted in a variety of studies and IRS improvement efforts. In 2005, the Future Field Collection Design study noted, "the CFf has not adopted a measure for compliance at any organizational level."[83] This study went on to recommend that "the CFf develop and implement an explicit compliance goal and measure," noting that it could "drive organizational behavior and performance that is consistent with CFf objectives to assure that Revenue Officer field presence and actions secure short- and long-term compliance."[84]

Inadequate measures for revenue protection and compliance have distorted the perceived "returns on investment" for the CFf and ACS. However, without meaningful measures in these critically important areas, the IRS will continue to exaggerate the positive returns on investing in centralization, and devalue the potential benefits of wise investments in the CFf.

Small businesses with tax problems represent a particular group of taxpayers with similar needs, which are best met by a local IRS presence with a focus on increased compliance.

The scope of IRS collection cases is diverse, including a broad range of taxpayers with differing needs. When used in a service-oriented manner, the field-based Revenue Officer position is uniquely positioned to address the needs of certain segments of the population of delinquent taxpayers, particularly small businesses with tax debts. The under-utilization of Revenue Officers to address employment tax delinquencies in a timely, service-oriented

81 IRS, Collection Activity Reports, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012), NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Oct. 2012).

82 IRS, Collection Activity Report, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Oct. 2012). The CNC inventory contained 3,389,745 taxpayer accounts as of September 2012.

83 IRS, FFCD Project Team, *Future Field Collection Design, Current State Design* 13 (Nov. 10, 2005).

84 IRS, FFCD Project Team, *Future Field Collection Design, Future State Design – Final Report* 2 (June 6, 2006).

manner contributes to lost revenue and lost opportunities to promote voluntary compliance.

The IRS's focus on "complexity" in determining the most appropriate role for the Revenue Officer in collection casework fails to recognize that in most cases, "complexity" is an unfortunate byproduct of inadequate concern for taxpayer service. Failure to intervene early in emerging tax delinquencies, inadequate attention for collection accounts in the Collection Queue, and a reluctance to use flexible payment options to arrive at mutually agreeable payment solutions create "complexity" in cases that could otherwise be resolved more expeditiously.

The National Taxpayer Advocate is concerned that Collection has closely linked the resolution of "complex" cases by Revenue Officers to the need to employ technically complex enforcement tools, with very little emphasis on the "complex" payment alternatives such as offers in compromise, non-streamlined installment agreements, and lien withdrawals. Consequently, the CFf appears to be developing into a cadre of enforcement specialists. Yet, there are no indications that this imbalanced approach has produced more revenue, or more effectively promoted the future compliance of taxpayers.

Further, the IRS fails to routinely measure critical factors such as the age of collection accounts upon delivery to the CFf, revenue lost to untimely treatments, and variations in the future compliance of taxpayer segments by treatment (field *v.* ACS). Nevertheless, these issues must be considered in determining the true "return on investment" for Revenue Officers, and ensuring that the IRS is staffed to provide high-quality service to all taxpayers with debt problems.

CONCLUSION

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Use direct assignments to the CFf for cases that are most likely to be fully resolved in the field environment, with particular emphasis on in-business taxpayers with employment tax delinquencies.
2. Reevaluate and redesign the Collection Queue concept, including the assignment of accountability for the overall Queue inventory to a specific Collection executive. While it may be practical to maintain temporary "secondary inventories" at the Collection Area or group levels, specific CFf managers should be accountable to the taxpayers assigned to these inventories.
3. Empower all Revenue Officers to recommend the acceptance of offers in compromise.
4. Revise the delegated authority for issuance of lien withdrawals so that any Revenue Officer who can independently file an NFTL also can issue a lien withdrawal.
5. Develop and implement measures for the Collection operations that accurately represent the outcomes the IRS is trying to achieve. In addition to measures reflecting the

recovery of delinquent revenue, along with new measures to track revenue protected (*e.g.,* project the reduction of lost revenue tied to the prevention of the pyramiding of liabilities), the most critical needs are for measures illustrating the short and long-term compliance benefits of Collection treatments. We suggest the following:

- Track and evaluate the number and percentage of taxpayer entities brought into full compliance at the conclusion of specific collection treatments (short-term compliance),
- Track and evaluate the long-term effectiveness of collection treatments on taxpayer compliance, *e.g.*, the number and percentage of taxpayers that remain in compliance for the five years following the collection treatment (long-term compliance).

IRS COMMENTS

The IRS must continually balance the ability to service our taxpayers with sound fiscal management practices, resolving cases at the business unit where it is most cost effective to do so. Currently, there are in excess of 1.1 million cases in the collection queue.[85] Revenue officers are the most skilled and highly paid employees in the collection area. With less than 3,400 bag-carrying revenue officers available to work these cases, it is imperative that IRS continues to prioritize workload to ensure coverage of priority work.[86]

In the National Taxpayer Advocate's report, the National Taxpayer Advocate notes that the Automated Collection System has not been successful in collecting business taxes, noting that in FY 2012, 62 percent of employment tax cases routed through the automated system left ACS as unresolved accounts. However, by routing these cases through ACS first, IRS was able to resolve over 249,000 delinquent modules, resulting in $243 million secured.[87] By allowing these to go through ACS, the ability to work these cases was greatly enhanced as they would otherwise have first been placed in the queue awaiting assignment given the limited field resources.

The IRS recognizes the benefit of early intervention in employment tax cases and, as such, has made significant efforts to expand the current Federal Tax Deposit Alert program. In 2012, the IRS implemented a pilot initiative where a "Soft Letter Notice" is used to contact business taxpayers in which account indicators are present that a potential tax liability will exist for the business due to reduced federal tax deposits. The soft letter notice explains the importance of making timely federal tax deposits and the consequences of failure to do so. The letter also reminds the taxpayer to file timely Form 941, *Employer's Quarterly Federal Tax Return*, to prevent additional penalties and provides IRS contact information if assistance is needed. While the results of the pilot are currently being evaluated, preliminary

85 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

86 IRS, Collection Activity Report, NO-5000-23, *Collection Workload Indicators Report* (Oct. 2012).

87 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012)

feedback suggests that this effort has been effective in providing education to taxpayers before significant liabilities accumulate and allowing the IRS to react faster and earlier to indicators that a business may be in trouble.

IRS collection programs continually monitor performance using a diverse array of measures and diagnostic indicators to assess and improve organizational results. These metrics help leadership evaluate the efficiency of critical business processes and the effectiveness and quality of major program inputs and outputs. Like other large IRS programs, Collection uses a balanced measures approach that focuses on employee engagement, customer satisfaction, and business results as they make strategic and operational decisions to deliver its mission. We track these different suites of measures at the enterprise level and for each collection program; and where appropriate, outcome-neutral measures are used to assess the performance of field and campus offices.

The National Taxpayer Advocate makes five preliminary recommendations in her Most Serious Problem report. The IRS will take or has taken the following actions with respect to these recommendations.

Based on current staffing and system resources, it is not feasible to directly assign all cases that are most likely to be resolved in a field environment directly to Field Collection. However, cases in the queue are prioritized and the inventory is presented for assignment in priority order using business rules and sophisticated analytics. In-business cases with employment tax delinquencies are considered high priority cases. Other than cases identified as mandatory assignments, such as FTD Alerts and cases with a balance due in excess of $1 million, business cases with employment tax delinquencies are listed first for the manager to assign when selecting cases to replenish a Revenue Officer's inventory.

The Collection Queue is managed corporately. This corporate approach allows for more effective case management while the cases are awaiting assignment. For example, the Inventory Delivery System (IDS) is programmed to conduct an annual systemic queue review and may route cases awaiting assignment to other work streams if new conditions have occurred. In addition, taxpayer correspondence and incoming calls on these cases are more efficiently addressed by these other collection work streams and not by one specific collection executive.

The IRS believes that the offer in compromise is an effective tool for resolving outstanding liabilities. Working an OIC case requires specialized skills and a concentrated effort on the part of our offer specialists. The IRS believes that revenue officers should be aware of the offer program as a tool to resolve a taxpayer's liability. The revenue officer working the case is in a position to make an initial recommendation regarding the feasibility of the OIC. As such, the IRS is in the process of revising Form 657, *Offer in Compromise Revenue Officer Report*, and will be adding a box to the form that will allow a revenue officer to check "yes" if he or she believes the offer should be accepted. In addition, if the revenue officer indicates the offer should be accepted and a decision is subsequently made to reject the OIC, guidance is being issued requiring the investigating offer specialist or offer

examiner to contact the revenue officer and explain the reasoning as to why the offer is not being recommended for acceptance.

The IRS does not agree that all revenue officers who can independently file an NFTL should also be able to issue a lien withdrawal.[88] As with other types of enforcement tools that impact the overall fairness and equity of the tax system, the IRS has put into place a set of safeguards to ensure that proper case decisions and actions are made. This set of safeguards provides for a separate authority to issue the NFTL withdrawal. However, the IRS does recognize the need for the timely processing of the NFTL withdrawal when this action is appropriate. As such, in May 2012, the IRS revised Delegation Order 5-4, Federal Tax Lien Certificates, to provide additional NFTL withdrawal authorities. For cases assigned to Field Collection, the authority to withdraw an NFTL, or reject a request to withdraw an NFTL, was given to Revenue Officer Group Managers for situations where the NFTL was premature or the lien has already been released. In addition, the authority to withdraw or reject a request to withdraw an NFTL was given to Advisor/Reviewers in situations including Direct Debit Installment Agreements and where the lien has already been released. The authority to withdraw or to reject a request to withdraw an NFTL was given to Centralized Case Processing Managers for Automated Lien System Units in situations where the lien has already been released with the exception of liens that have self-released; and authority to withdraw or reject a request to withdraw an NFTL was given to Appeals Team Managers as part of a Collection Due Process Hearing or Equivalent Hearing Determination or, after the opportunity for dissent, as part of a Collection Appeals Program Decision.

The IRS agrees that helping taxpayers resolve tax debts and delinquencies and maintain compliance are key outcomes of IRS collection programs. To support the achievement of these outcomes, collection routinely reviews operational results and sponsors research studies to better understand the effectiveness of specific programs and resolution strategies. This information is used to inform work plan development and initiatives, case selection and prioritization rules, and resource allocation decisions. The IRS is already analyzing the long-term compliance trends of taxpayers who have been through the collection process. Understanding how taxpayer needs and expectations influence collection outcomes is critical for improving current collection strategies and for creating new tools and options that benefit both taxpayers and tax administration.

We agree that Collection programs should assess results in promoting both short-term and long-term compliance. We are already pursuing research along these lines and will continue to do so. Developing an understanding of taxpayer compliance trends and the differential impact of available collection treatments require detailed analysis of historical compliance data (often over extended timeframes). This is better achieved through rigorous research of the kind we are already undertaking rather than through additional measure reporting in our management information systems.

[88] The IRS does not have the statutory authority to withdraw a lien. Only the "notice" of the lien's existence (NFTL) may be withdrawn.

Taxpayer Advocate Service Comments

Although the National Taxpayer Advocate acknowledges the challenges inherent in balancing service delivery with "sound fiscal management" (*i.e.*, efficiency), for more than a decade she has stressed that these two objectives are not mutually exclusive. Particularly in regard to the IRS Collection operation, it has become increasingly clear that timely and effective taxpayer service is a critical component of a truly cost-effective collection strategy. Unfortunately, the IRS response to this report does not indicate that Collection has accepted that connection.

The IRS cites the $243 million of employment tax debts collected by ACS in FY 2012 as the core benefit of initially routing the majority of business tax delinquencies through these call centers. However, this analysis overlooks the fact that *overall* dollars collected on BMF accounts *declined* by $378 million in FY 2012 — a year in which significantly more BMF cases were routed through ACS.[89] Further, the IRS response does not mention as a matter of concern the $2.1 *billion* in BMF accounts transferred by ACS to the Collection Queue in FY 2012.[90]

Past IRS studies have consistently concluded that ACS has not been effective in fully resolving most BMF tax delinquencies, and the IRS response provides no new data analysis to support current case assignment practices in this area. Rather, the IRS response assumes that the only realistic alternative to routing most BMF cases through ACS is to place them in the Collection Queue, and cites "limited field resources" as the basis for this assumption.

Currently, Revenue Officers make up approximately 55 percent of the collectors assigned to the Small Business/Self-Employed operating division.[91] The IRS states that, with few exceptions, employment tax cases have the highest level of priority for Collection Field assignment. Yet as of September 2012, fewer than half of the taxpayer cases in CFf inventory involved BMF accounts, and employment tax delinquencies accounted for only 42.6 percent.[92] On the other hand, almost three times as many employment tax cases were sitting in the Collection Queue — aging, very likely pyramiding additional liabilities, and becoming increasingly uncollectible.[93] In addition, the IRS has acknowledged that ACS collectors lack the training or delegated authorities to resolve most accounts where a BMF taxpayer cannot immediately full pay the balance due, or qualify for a streamlined installment agreement.[94]

89 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

90 *Id.*

91 IRS response to TAS information request (Aug. 14, 2012). As of June 2012, SB/SE reported 3,459 Revenue Officers working collection inventories and 2,885 collection tax examiners working cases.

92 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012). As of September 2012, the IRS reported 174,057 taxpayer cases in the CFf inventory, of which 81,716 were BMF accounts and 74,125 involved trust fund tax liabilities.

93 *Id.* As of September 2012, the IRS reported 207,349 taxpayer cases involving trust fund delinquencies in the Collection Queue inventory.

94 IRS response to TAS information request (Sept. 7, 2012).

The National Taxpayer Advocate recognizes the IRS's efforts to expand the use of the FTD Alert program as a positive development, but questions whether the use of soft notices will be as effective as personal contacts from Revenue Officers in fully meeting the needs of this segment of the taxpayer population. We believe that failure to employ Revenue Officer resources in a timely manner to BMF tax debts is potentially harmful to the small business community, and causes the government to lose significant amounts of revenue.

The National Taxpayer Advocate acknowledges as a positive development the proposed change to Form 657, *Offer in Compromise Revenue Officer Report*, in which Revenue Officers will be able to recommend the acceptance of the taxpayer's offer, as well as propose a rejection. However, this change does little to alleviate the "bottleneck" in the IRS's ability to receive and work OICs; nor will it expand the ability of the IRS to consider more offers in a timely manner.

Moreover, we do not agree that working an OIC case requires more "specialized skills and concentrated effort" than is already required in Revenue Officer casework. It is the policy of the IRS that an OIC is a viable alternative to reporting an account as uncollectible, or to a protracted installment agreement. Currently, Revenue Officers can recommend cases for partial payment installment agreements (PPIA) and report accounts as currently not collectible (CNC). The consideration of an OIC is no more technically complex than these other alternatives. Further, as of September 2012, almost 70 percent of the open TDAs in Collection inventory involved tax delinquencies from 2008 and prior years.[95] In other words, the bulk of the Collection workload consists of aged cases that are prime candidates for OICs. Failure to expand the use of the OIC to resolve more of these cases will likely result in lost revenue and lost opportunities to improve voluntary compliance.

In a similar manner, the IRS response regarding expanding authority for Revenue Officers to issue lien withdrawals does little to reduce the "bottleneck" condition that confronts taxpayers attempting to secure a withdrawal. The National Taxpayer Advocate agrees with the IRS on the importance of "safeguards to ensure that proper case decisions and actions are made" in IRS enforcement actions. However, these safeguards are no less important in determining the need to *file* a Notice of Federal Tax Lien than in deciding to withdraw the notice. Of particular note, in the IRS Restructuring and Reform Act of 1998, Congress passed legislation requiring an IRS supervisor's approval prior to filing a notice of lien in order to affirm that the action was appropriate under the taxpayer's circumstances.[96] However, no such approval requirement was even suggested for lien withdrawals. Yet, the IRS currently requires managerial approval for all lien withdrawals, while most Notices of Federal Tax Lien are filed with no approval at all.

95 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

96 Section 3421 of Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) provides that, where appropriate, a supervisor review the proposed lien filing, considering the amount due, the value of the taxpayer's assets, and affirm the lien-filing is appropriate under the circumstances. RRA 98, Pub. L. No. 105-206, Title III, § 4321, 112 Stat. 685, 758 (1998).

We applaud the decision to delegate lien withdrawal authority to Appeals Team Managers as an important step in the right direction, and acknowledge the limited authority delegated to Revenue Officer Group Managers as a positive development. Nevertheless, we continue to believe a broader delegation of this authority is appropriate.

Lastly, we do not dispute that the IRS tracks and monitors volumes of program-related data — our concern is what data the IRS is *not* tracking. As the National Taxpayer Advocate discussed in the 2010 Annual Report to Congress, most of the performance measures by which the IRS evaluates the Collection operation focus on production and efficiency.[97] By comparison, very few metrics are available to assess service and quality-related issues that directly impact taxpayer satisfaction with the IRS collecting process. The National Taxpayer Advocate is concerned that taxpayer perceptions of imbalances between production efficiencies and quality taxpayer service, as well as the restricted use of problem-solving tools (*e.g.,* OICs, IAs, lien withdrawals) as opposed to the liberal use of automated enforcement actions (*i.e.,* liens and levies) may actually contribute to non-compliance in certain segments of the taxpayer population.[98]

Moreover, the IRS has done very little to measure the impact of Collection operating units and treatments in the areas of delinquency prevention (*i.e.,* revenue protection) and voluntary compliance. The IRS contends that it has employed research studies to develop "an understanding of taxpayer compliance trends and the differential impact of available collection treatments" on taxpayer behavior. To date, however, we have seen very little IRS-generated data in these areas. A greater concern, however, is that research studies do not drive organizational performance in a manner that can be achieved through meaningful performance measures. Until this "measures gap" has been corrected, the IRS will continue to struggle to accurately assess the return on investment for its Collection programs.

97 *See* National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*).

98 For a detailed discussion of this issue, see *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, vol. II, *infra*/*supra*.

Recommendations

In summary, the National Taxpayer Advocate recommends that the IRS:

1. Use direct assignments to the CFf for the cases most likely to be fully resolved in the field environment, with particular emphasis on in-business taxpayers with employment tax delinquencies.
2. Reevaluate and redesign the Collection Queue concept, including the assignment of accountability for the overall Queue inventory to a specific Collection executive. While it may be practical to maintain temporary "secondary inventories" at the Collection Area or group levels, specific CFf managers should be accountable to the taxpayers assigned to these inventories
3. Empower all Revenue Officers to evaluate offer in compromise applications and recommend the acceptance of OICs.
4. Revise the delegated authority for issuance of lien withdrawals so that any Revenue Officer who can independently file an NFTL also can issue a lien withdrawal.
5. Develop and implement measures for the Collection operations that accurately represent the outcomes the IRS is trying to achieve. In addition to measures reflecting the recovery of delinquent revenue, along with new measures to track revenue protected (*e.g.,* project the reduction of lost revenue tied to the prevention of the pyramiding of liabilities), the most critical needs are for measures illustrating the short and long-term compliance benefits of Collection treatments. We suggest that the IRS track and evaluate:
   - The number and percentage of taxpayer entities brought into full compliance at the conclusion of specific collection treatments (short-term compliance); and
   - The long-term effectiveness of collection treatments on taxpayer compliance, *e.g.,* the number and percentage of taxpayers that remain in compliance for the five years following the collection treatment (long-term compliance).

MSP #21

The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Faris Fink, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The Automated Collection System (ACS) is a computerized inventory system and telephone call center that assigns cases to contact representatives or tax examiners who interact with taxpayers about delinquent accounts.[1] ACS systemically sends taxpayers demand notices, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts. However, ACS's success in resolving cases and collecting tax due has been limited.

- In fiscal year (FY) 2012, ACS collected $2.8 billion (or only seven percent) of its $42.7 billion of receipts and productively closed only 41 percent of its total inventory.[2]
- In FY 2012, ACS transferred 1.17 million taxpayer delinquent accounts (TDAs) valued at $12.9 billion to the Queue.[3] The ratio of delinquent tax dollars transferred out of ACS to the amount actually collected by ACS was 4½ to one. The 1.17 million cases transferred had an average tax liability of $10,995.[4]

The National Taxpayer Advocate believes this poor performance is caused, in part, by ACS's automated, enforcement-oriented approach to working inventory.

- Only about two percent of all ACS's time is spent making outgoing calls. Instead, ACS relies on systemically generated levy notices and levies to generate taxpayer contacts.[5]
- ACS is entering into fewer installment agreements (IAs), despite the implementation of the IRS "Fresh Start" Initiative.[6] In FY 2012, the number of new ACS-approved IAs

1 ACS is designed to get the taxpayer into the ACS system as quickly as possible by sending them to the first available contact representative or tax examiner who can assist them, regardless of where the assistor is located geographically in the country.

2 Collection Activity Report, NO-5000-2, Taxpayer Delinquent Account Cumulative Report (Oct. 2012). Productive closed TDAs include full pays, installment agreements, and currently not collectible (CNC) hardship determinations. Numbers include ACS FY 2011 TDA ending inventory and ACS TDA receipts through March fiscal year 2012 (to allow ACS time to close cases).

3 TDAs are collection accounts that remain unresolved at the conclusion of the collection notice process, and have been designated by the IRS for additional collection activity, *e.g.*, ACS or the Collection Field function (CFf). A taxpayer may have multiple TDAs (*e.g.*, one for each different delinquent tax year). The Queue is a holding process where cases sit after having been worked in ACS, and before they are assigned for additional collection action by the CFf. Cases sit in the Queue based on business rules and resources available to work them.

4 Collection Activity Report, NO-5000-2, Taxpayer Delinquent Account Cumulative Report (Oct. 2012). ACS Transfer to Queue: $12,905,262,534 and 1,173,754 TDAs. Transfer to CFf: $1,122,486,037 and 111,686 TDAs. ACS to CNC: $3,824,972,103 and 966,614 TDAs.

5 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-30-046, *More Management Information is Needed to Improve Oversight of Automated Collection System Outbound Calls* 6 (Apr. 28, 2010). *See also* National Taxpayer Advocate 2011 Annual Report to Congress 336-349 (Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*).

6 Collection Activity Report NO-5000-6, Installment Agreement Cumulative Report (Oct. 2012), and Collection Activity Report NO-5000-2, Taxpayer Delinquent Account Report (Apr. 2012 and Oct. 2012). Although Business Master File (BMF) IAs increased by 12 percent, the number of BMF IAs issued by ACS is remarkably small – 31,070 for the year, or 4.4 percent of total ACS BMF Inventory (FY 2012 Receipts through March and ending inventory from FY 2011).

and streamlined installment agreements (SLIAs) decreased by one percent compared to FY 2011.

- About one out of every five calls to ACS cannot reach the IRS to resolve his or her issues. ACS had a Level of Service (LOS) of about 80.6 percent in both FY 2011 and FY 2012, which means nearly one of five calls went unanswered. Wait times averaged over eight minutes.[7]
- Taxpayers cannot work with the same ACS employee as they attempt to resolve their issues.

The National Taxpayer Advocate is concerned that ACS, in addition to using policies that do not embrace customer service, may not be working the correct inventory and that IRS business rules for determining which cases ACS should work may be flawed.

- An IRS study showed ACS was more successful at working Queue-type cases than other cases.[8] However, ACS does not often work these cases because they are not thought to be productive inventory.
- Twenty-five percent of ACS cases are defaulted IAs that have been through the collection process before. However, ACS places these cases back into its normal inventory to be worked.[9]
- ACS does not appear to be effective in fully resolving employment tax cases that require specific procedures to cure the delinquency issues and prevent future balances due.[10]

Despite these problems, the assessment of ACS service reflects high customer satisfaction and quality review scores. However, the design and administration of the survey raises concerns about the validity of the results.

7 Joint Operations Center (JOC) Reports for week ending Sept. 30, 2012. Snapshot report of Product Line Detail, Small Business/Self Employed Division (SB/SE) ACS 800-829-3903 and Wage & Investment (W&I) Division ACS 800-829-7650. The LOS and average speed of answer (ASA) are the weighted averages of SB/SE and W&I based on calls answered by each function.

8 IRS response to TAS research request (Oct. 24, 2012). In FY 2012, the percentages were 2.4 percent for SB/SE and 2.0 percent for W&I.

9 Collection Activity Report NO-5000-2, Taxpayer Delinquent Account Report (Apr. 2012)

10 See Most Serious Problem: *The Diminishing Role of the Revenue Officer has been Detrimental to the Overall Effectiveness of IRS Collection Operations, supra* for a discussion on employment tax pyramiding and ACS.

ANALYSIS OF PROBLEM

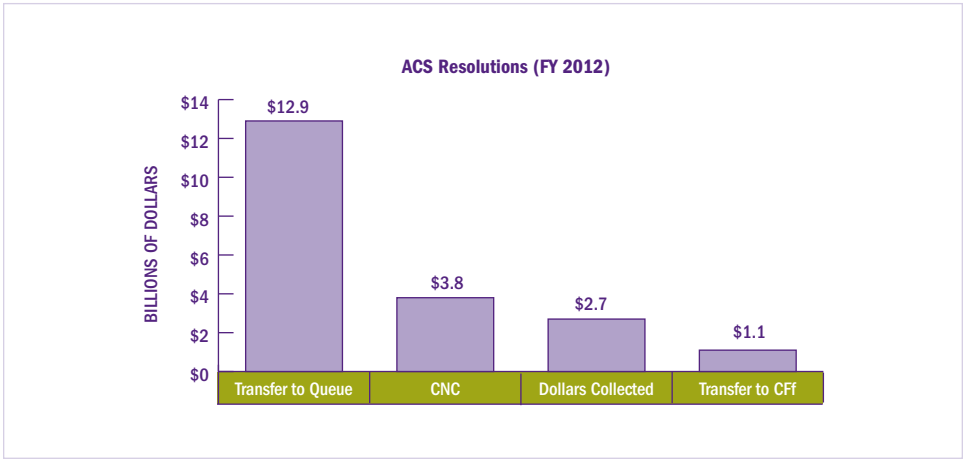
Background

The Collection Process

When taxpayers do not fully pay the taxes they owe, the IRS uses various techniques to collect the remaining balances. First, the IRS attempts to secure payment through a series of intermittently issued notices.[11] If notices do not yield resolution, the IRS assigns the account to ACS.[12] Cases that remain unpaid or unresolved in ACS are transferred to the Collection Queue or to the CFf.[13]

The Automated Collection System is an important component of the IRS tax collection operation, but its resolution rate for certain types of cases is low. The chart below shows the amounts collected by ACS in FY 2012, the amounts placed in CNC status, and the amounts transferred to the Queue and CFf, illustrating that most ACS inventory (by dollar amount) eventually lands in the Queue.

FIGURE 1.21.1, Dollars Collected and Transferred by ACS in FY 2012



11 The first notice, which explains the delinquency and requests payment, is generally issued within four to six weeks from the filing of the return or creation of additional tax assessments. If the balance remains outstanding, the IRS sends a final notice that urgently demands payment and warns the taxpayer of potential enforcement action. The IRS may begin enforcement 30 days after sending the final notice. Internal Revenue Code (IRC) § 6331.

12 IRM 5.19.5.1 (Mar. 6, 2009); IRM 5.19.5.2 (Dec. 1, 2007).

13 The CFf is predominantly staffed by revenue officers who make field contact with taxpayers, secure delinquent returns and financial information, initiate installment agreements, and take enforcement action including liens, levies, and seizures of property. They generally work the highest dollar and priority cases. The IRS uses Collection Inventory Management (CIM) tools to prioritize and assign cases. IRM 5.1.20.2 (May 27, 2008).

ACS Does Not Focus on Taxpayer Service to Improve Case Resolution.

The ACS began as a call center operation that devoted significant staff hours to outgoing calls. However, over the years its focus has changed from making outgoing calls in an effort to resolve cases to answering incoming calls generated by the notices and levies it sends out. ACS staff now spends about two percent of all its time making outgoing calls.[14] This is a shift from direct customer service to a reactive approach of managing taxpayers' calls.

ACS Relies on Systemic Generated Levy Notices and Levies to Generate Taxpayer Contacts.

In general, collection cases in ACS are most successfully resolved through direct contacts with the taxpayers. However, ACS's current collection strategy relies heavily on levy notices and systemically-generated levies to trigger a response from the taxpayer, even though several studies have demonstrated that less intrusive methods of contact may be more efficient and effective in generating responses. In fact, studies have been raising concerns regarding ACS collection strategy for more than 20 years.

Early Study Raising Concerns Regarding ACS Collection Strategy.

In 1991, the IRS conducted a study at the Newark and Houston call sites as part of the "Planning for Quality" redesign effort.[15] The IRS compared the effectiveness of four ways of contacting taxpayers:

1. A telecomputer predictive dialer;[16]
2. IRS employees making outgoing calls;
3. Sending letters to taxpayers requesting contact; and
4. Issuing levies.[17]

The study's general conclusion was that having IRS employees make outgoing calls was most effective in contacting taxpayers, and ultimately resolving cases. This study also noted the relatively high administrative cost of issuing the levy. Subsequent studies have also challenged the assumption that the levy is the most effective method of establishing contact with a taxpayer.

14 IRS response to TAS research request (Oct. 24, 2012). In FY 2012, the percentages were 2.4 percent for SB/SE and 2.0 percent for W&I.

15 See ACS Telephone Response Study, Kansas City Customer Service Site March-April 2000. This study discussed the 1991 Newark and Houston call site study.

16 A predictive dialer is a telephone control system that automatically calls a list of telephone numbers in sequence, screening out no-answers, busy signals, answering machines and disconnected numbers, and predicting when a live person will answer the call. Further, use of the telecomputer in this study did not focus on simply leaving callback messages, as the current predictive dialer does. The telecomputer activity referenced in this study actually connected an answered call to a live assistor, which was an effective method of making outcalls.

17 ACS Telephone Response Study, Kansas City Customer Service Site March-April 2000.

Kansas City Service Site Study Conducted in 2000

In a 2000 study completed by the Kansas City customer service site, the IRS set out to determine taxpayer response rates for ACS letters, notices of levy, and levies.[18] The letters included in the study were:

- LT 11 - *Final Notice of Intent to Levy and Your Notice of a Right to a Hearing*;[19]
- LT 16 - *Letter, Please Call us About Your Overdue Tax or Tax Return*;[20]
- LT 40 – *Advisory Notice to Taxpayer of Need to Contact Third Parties*;[21]
- LT 99 – *Please Call Us About Your Overdue Taxes or Tax Returns* — same letter as LT 16 but mailed out when a new case comes to ACS, generated by the system if requested by the site; [22] and
- Levy – the levy is sent to both the taxpayer and the source of the levy (*e.g.*, employer or bank).[23]

The study concluded that all of the ACS letters were more effective than levies in prompting telephonic customer contact. The chart below provides the specific response rates for each letter and the levy:

18 ACS Telephone Response Study, Kansas City Customer Service Site March-April 2000. The study was conducted by analyzing 2,000 TDAs that had LT 11, 16, 40, 99, and levies issued. The sample consisted of 400 accounts for each of the letters and levies. The KCSC study looked at each treatment separately, *i.e.*, the study took a sample of cases and issued LT 11, 16, 40, 90, and levies and tracked the response rate of each.

19 Final Notice, *Notice of Intent to Levy and Your Notice of a Right to a Hearing*, is sent by certified mail with a return receipt and is required before the IRS can take any enforcement action.

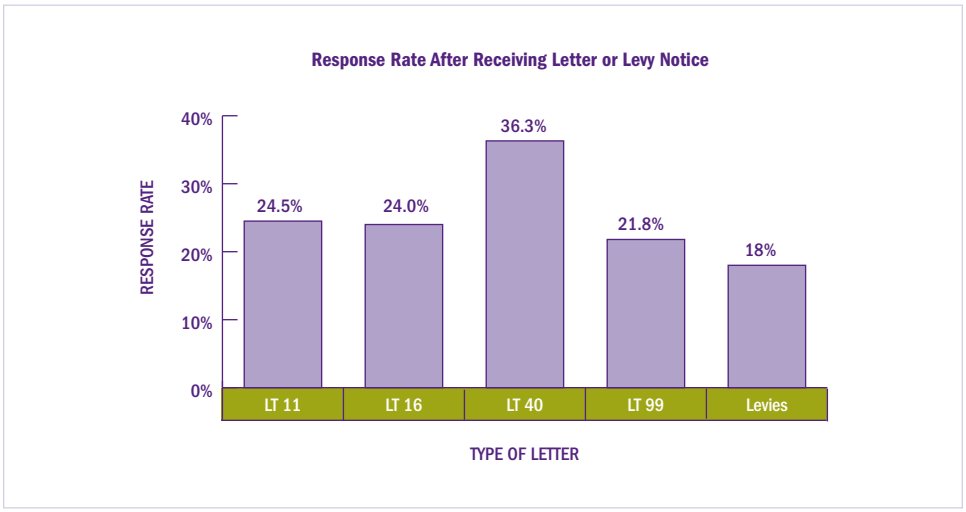
20 Letter 16, *Please Call us About Your Overdue Taxes or Tax Return*, asks the taxpayer to call the IRS regarding overdue taxes or tax returns.

21 Letter 40, *Advisory Notice to Taxpayer of Need to Contact Third Parties*, advises the taxpayer that the IRS could be contacting a third party regarding a balance due and does not require a response. Even though it requires no response by taxpayers, the study found it was the most effective tool in prompting telephonic customer contact, because taxpayers were concerned that their neighbors or employers would become aware of their affairs. (This form letter is no longer in use.)

22 LT 99, *Please Call Us About Your Overdue Taxes or Tax Returns*, is the same as letter 16 but mailed out when a new case comes to ACS.

23 A levy is sent to both the levy source and the taxpayer. The levy sources may have been contacted on some of the cases in order to verify financial relationship with the taxpayer.

FIGURE 1.21.2, Results of the Kansas City Service Site Study[24]



As illustrated above, the levy yielded the lowest response rate at 18 percent (all letters yielded a response greater than 20 percent).[25] Further, two-thirds of the responses generated by the levy were calls from third parties that likely called to inform the IRS that the taxpayer was no longer associated with them (*i.e.,* no longer employed with them or having no funds in the account) or to ask how to comply with the levy. In other words, only six percent of the levies actually led to taxpayer contacts. Further, the study showed that when taxpayers responded to the letters and notices by phone, 27.7 percent of the contacts resulted in the case being closed, while closing actions on cases that did not respond by phone totaled only 14.4 percent. This further supports previous findings that phone contact with the taxpayer is the most successful way to resolve a case.

Small Business/Self-Employed Division 2012 Research Study

In the most recent study, conducted in 2011, SB/SE analyzed a large sample of cases closed in ACS during the month of May 2011 and reviewed actions taken in these cases in the 180 days prior to the closure.[26] The study recommended the following actions to improve ACS's case resolution rate:

- Maintain sufficient staffing to answer taxpayer phone calls promptly, because telephone contact with ACS taxpayers is the number one action that leads to case closure; and

24 ACS Telephone Response Study, Kansas City Customer Service Site March-April 2000.

25 *Id.* On average, 28.5 percent of the letters were returned as undelivered mail.

26 Automated Collection System (ACS) Closed Case Actions Project DEN0181, SB/SE Research (Aug. 2012). This study looked at 83,365 taxpayers with ACS SB/SE cases in inventory during FY 2011 that closed during May 2011. ACS TDA closures fall into three categories: 1) Status 12 Fully Satisfied; 2) Status 60 Installment Agreement; and 3) Status 53 CNC. Fully Satisfied applies to cases that were resolved by payment, abatement of assessed amounts, or a combination. Installment agreements are not fully satisfied at time of closure, and the case may reopen if the taxpayer does not keep the terms of the agreement. Cases closed as CNC have a balance due that is not being pursued.

- Consider issuing levies where warranted as over half of the ACS taxpayers with levies immediately called ACS, and calls are a leading factor in case closure.[27]

The National Taxpayer Advocate fully supports the recommendation that ACS maintain sufficient staffing to answer taxpayer phone calls promptly, and agrees with the observation that personal taxpayer contact is the key factor in resolving ACS cases. Additionally, the National Taxpayer Advocate agrees that ACS resources should be used in a manner that maximizes the benefits from these contacts. However, the implication that ACS levies are the optimum method for generating taxpayer contacts is questionable, and not completely supported by the data contained in the report.

For example, of the approximately 73,000 closed TDA cases analyzed by the study, only about 35 percent contained evidence of an ACS levy.[28] Even assuming the levy was needed to close these cases (which the report does not show), it remains that nearly two thirds of the cases closed without levies. Further, although the study noted that personal contact by ACS with delinquent taxpayers was a critical factor in bringing ACS cases to resolution, only about 20 percent of the taxpayers in the sample called ACS as a direct result of a levy.[29] About 80 percent of the calls resulted from less intrusive IRS actions.

The study also only looks at case closures. The study does not consider the number of cases in which levies are imposed and the cases remain open, or compare this track record to alternative approaches, such as IRS outbound calls to taxpayers.

Although the IRS invests heavily in issuing levies from ACS to generate taxpayer contacts and case resolutions, *i.e.*, ACS issued 2.9 million levies in FY 2011,[30] there is very little evidence that this contact strategy is highly effective. In light of the findings in both the 1991 Newark and Houston call site and the 2000 Kansas City Customer Service Site studies, discussed earlier, as well as this most recent study, it seems a reasonable conclusion that an outbound call or a less intrusive letter may actually be more effective in resolving accounts, while being less economically damaging to taxpayers. The IRS data indicates that levies should not be relied upon as the primary precursor to a conversation with the taxpayer. A strategy that instead emphasizes prompt outgoing calls to taxpayers resolves cases by helping taxpayers understand the issues, what payment alternatives exist, and how to avoid delinquencies in the future.

27 Automated Collection System (ACS) Closed Case Actions. Project DEN0181, SB/SE Research (Aug. 2012).

28 Automated Collection System (ACS) Closed Case Actions Project DEN0181, SB/SE Research 16 (Aug. 2012). The study includes 83,365 closed cases, of which 72,770 were TDA cases and the remainder were taxpayer delinquent investigation (TDI) cases. The IRS initiates a TDA investigation when the taxpayer has an unpaid tax liability and initiates a TDI investigation when the IRS believes that the taxpayer has not filed a required return. Therefore, the levy analysis was only conducted on the cases that had an outstanding liability.

29 Automated Collection System (ACS) Closed Case Actions Project DEN0181, SB/SE Research 17 (Aug. 2012).

30 Collection Activity Report, NO-5000-23-10 (Oct. 2011).

ACS is Entering into Fewer Installment Agreements, Despite the Implementation of its "Fresh Start" Initiative.

In February of 2011, the IRS announced its "Fresh Start" initiative, which provided taxpayers with more flexible methods of meeting their tax obligations and a more moderate collection enforcement policy.[31] In January of 2012, the criteria governing this initiative were expanded. Specifically, taxpayers could now enter into a Streamlined Installment Agreement (SLIA) if the liability is fully paid within six years (taxpayers previously had only five years to full pay).[32] Considering the flexible options of the Fresh Start initiative, the National Taxpayer Advocate anticipated an increase in ACS IAs. However, in FY 2012, the number of IAs ACS entered into actually *decreased* by one percent compared to FY 2011.[33]

This decline may be explained by the current procedural guidance, which continues to serve as a barrier to the IRS's ability to realize the benefits the Fresh Start changes were intended to provide.[34] In its discussion with the IRS, TAS has recommended that the IRS clarify the following points in revisions to guidance to complement and support Fresh Start:

- After taxpayers inform the IRS they are unable to full pay, IRS employees should inform them of all collection alternatives, including Fresh Start options, and not focus only on full payment through liquidation of assets;
- Taxpayers should be advised of payment options, such as SLIAs, the new "six year rule," and offers in compromise earlier in the collecting process;
- Taxpayers should not have to liquidate the equity in available assets to qualify for an installment agreement. A taxpayer should not be placed into a long-term hardship situation by liquidating all assets, which he or she may need to live on in the future, to qualify for an installment agreement; and
- The IRS should explore mutually beneficial payment options with taxpayers who may have unfiled returns at the time of the initial contact. The need to resolve return delinquencies should be recognized as a component of the taxpayer's delinquency problem and considered as a condition to finalize a payment agreement, but should not be an absolute prerequisite for initiating the discussion. (Discussion with the taxpayer about the available collection alternatives may serve as an incentive for the taxpayer to file the delinquent returns.)

31 IRS, Media Relations Office, IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start, IR-2011-20 (Feb. 24, 2011). A SLIA is an agreement under $50,000 that will be fully paid in six years or less.

32 IRS, Interim Guidance, Control Number SBSE-5-MM12-002, Interim Guidance to Change Five-Year Rule to Six-Year Rule (Jan. 5, 2012).

33 The overall number of standard IAs the IRS entered into during FY 2012 decreased by two percent compared to FY 2011 and the overall number of SLIAs the IRS entered into in FY 2012 decreased by four percent. Collection Activity Report NO-5000-6, Installment Agreement Cumulative Report (Oct. 2012).

34 IRM 5.19.1 (Apr. 1, 2011).

The IRS's failure to identify and address the foregoing procedural and cultural barriers that prevent ACS from fully embracing the flexibilities provided by the Fresh Start initiative is causing ACS to enter into fewer IAs, collect less revenue, and ultimately bring fewer taxpayers into compliance.[35]

ACS Level of Service on the Phones Remains a Concern.

When taxpayers do call ACS, they may wait on the line for a long time and may not get through to an ACS employee at all. The average wait time on the ACS phone line is 8.3 minutes, and ACS's combined LOS was about 80.6 percent in FY 2011 and FY 2012, which means nearly 20 percent of calls, or one out of every five, goes unanswered.[36] Although this LOS ranks among the best for IRS telephone lines, it is not acceptable for a phone line dedicated to taxpayers who owe a tax debt and are calling to either make payment arrangements or avoid economic harm.[37] In addition to ensuring that the phone lines are properly staffed, ACS may be able to reduce incoming calls by attempting to resolve taxpayers' cases early in the process with outgoing calls.

ACS Does Not Allow Taxpayers to Deal with the Same Employee to Resolve a Case.

When a taxpayer does reach ACS, he or she is routed to the next available employee. A taxpayer who has to call ACS multiple times finds it virtually impossible to work with the same employee to resolve the case. Instead, taxpayers provide information several times and start resolution discussions all over again with different employees. Although initially ACS adopted a "one-call-does-it-all philosophy" and recommended that taxpayers be able to reach ACS employees by extension, it abandoned that approach many years ago.[38]

TAS frequently hears complaints from taxpayers about delays in responding to questions, the inability to speak with the same ACS employee or their manager, and overall lapses in ACS customer service. This has been confirmed by tax professionals at IRS Nationwide Tax Forum focus groups.[39] Some of the comments included:

- Taxpayers cannot work with one ACS assistor from start to finish and must retell their circumstances to each new assistor;
- Different assistors ask for different information to resolve the issue; and

35 IRM 5.19.1 (Apr. 1, 2011). Currently, IRS guidance directs ACS employees to focus on getting the taxpayer to full pay, even if it means securing a loan or liquidating assets. ACS focuses on full payment, even after the taxpayer has told them they cannot full pay, rather than exploring other collection alternatives.

36 Joint Operations Center (JOC) Reports for week ending September 30, 2012. Snapshot report of Product Line Detail, SB/SE ACS 800-829-3903 and W&I ACS 800-829-7650. The LOS and ASA are the weighted averages of SB/SE and W&I based on calls answered by each function. ASA is measured as the average length of time a caller spends on a secondary application before connecting to an agent. It does not include the time on hold with ATT or Verizon or on the call with the agent. Based on ACS LOS reports in FY 2012 (through Sept. 30, 2012) the SB/SE ACS incoming telephone line answered nearly 2.3 million calls out of 3.6 million net attempts by taxpayers. The telephone line has an LOS of 79.03 percent and an ASA of ten minutes; W&I ACS line answered 2.6 million out of 3.8 million attempts. That line has an LOS of 82.04 percent and an ASA of 6.7 minutes. By way of comparison, if the taxpayer does not call the ACS lines and calls the AM lines, they have an LOS of 67.6 percent and an ASA of nearly 17 minutes.

37 For a discussion of the level of service on various IRS telephone lines, see Most Serious Problem: *IRS Telephone and Correspondence Services Have Deteriorated Over the Last Decade and Must Improve to Meet Taxpayer Needs*, *supra*.

38 ACS Redesign Project, Working the Right Cases, at the Right Time, in the Right Way (June 1998). The study suggested that ACS design extension routing capability into ACS call routing procedures. This technology would allow the customer to work with the same ACS employee regarding an ongoing collection matter.

39 IRS, 2008 Nationwide Tax Forum Focus Groups conducted by TAS – Understanding the Practitioner Experience with ACS.

- The knowledge level of assistors seems to vary greatly, which was directly proportional to their courtesy, professionalism, flexibility, and ability to "think outside the box" to resolve problems.

To address these comments, the IRS should design extension routing capability to allow the taxpayer to work with the same employee until the case is resolved.[40] Such a capability would create continuity in the ACS communication process and make it easier for taxpayers to provide additional information to the IRS, as required, to reach an appropriate resolution for their accounts. It would also decrease ACS re-work. In addition to designing extension routing capabilities, the IRS should develop Virtual Service Delivery capabilities allowing taxpayers to schedule an appointment to meet "face-to-face" virtually with an ACS employee by videoconference, provide information, fill out financial information, and discuss payment options, all in real time.[41] This modernization would allow the IRS to resolve taxpayer issues more swiftly and reduce correspondence.

Finally, complex cases that generally require multiple contacts between the taxpayer and ACS may be worked more effectively in the field by a revenue officer. This is especially true where a taxpayer has a large liability or complex financial circumstances, or the case requires business-related financial analysis, *i.e.*, BMF accounts.[42] However, in recent years, the IRS has been doing the opposite (assigning cases with higher dollar amounts, and more BMF cases, to ACS).[43]

ACS Needs to Reevaluate the Types of Cases It Works and How it Works Those Cases.

ACS may not be prioritizing its case inventory in a manner that will yield the best results, *i.e.*, resolve cases and collect unpaid tax. For instance, cases where the IRS has previously made contact with the taxpayer, such as those involving defaulted installment agreements, are being worked in the order received, even when a quick call soon after the default could bring the taxpayer back into compliance. Additionally, other cases that ACS could work successfully, as described below, are instead being assigned to the Queue.

A Cost Effectiveness Study, Conducted By the IRS as Part of the Private Debt Collection Program, Found that ACS Might Not Be Working the Best Cases.

Cases that ACS has been unsuccessful at resolving are likely to land in the Queue, which is a holding process for cases awaiting assignment and further action by the IRS. Most cases flow from the notice process into ACS and generally stay there for six to nine months, until

40 Automated Collection System (ACS) Redesign Project, *Working the Right Cases, at the Right Time, in the Right Way* (June 1998).

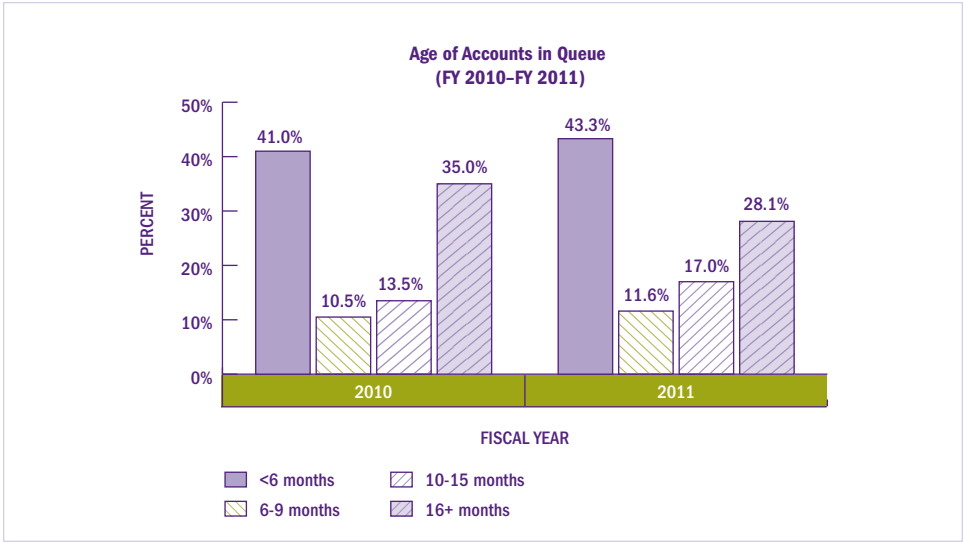
41 See Status Update: *The IRS Has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand its Initiative to Meet Taxpayer Needs and Improve Compliance*, *infra*.

42 See Most Serious Problem: *The Diminishing Role of the Revenue Officer has been Detrimental to the Overall Effectiveness of IRS Collection Operations*, *supra*, for a discussion of employment tax pyramiding and ACS.

43 IRS, SERP Alert 12A0587, *Increase in Automated Collection System IMF TDA Threshold for SB/SE and W & I*, (Oct. 15, 2012). Beginning October 29, 2012, ACS increased the threshold for tax liabilities on individual accounts for cases it will work form $100,000 to $250,000.

transferred to the Queue or CFf. Cases will sit in the Queue until the IRS deems them appropriate for application of resources, which could be months. For example, the mean age of the accounts in the Queue was 75 weeks in FY 2010; in FY 2011 it was 64 weeks, and 73 weeks in FY 2012.[44]

FIGURE 1.21.3, Accounts in Queue by Age



As of FY 2012, there were 3,867,953 Taxpayer Delinquent Accounts (TDA) totaling $63.1 billion in the Queue. In FY 2012, ACS transferred 1,173,754 TDAs to the Queue.[45] Of the cases in the Queue reported by the IRS as "dispositions," approximately 61 percent were systemically reported as uncollectible, *i.e.* the IRS made a decision that the accounts did not warrant investing Collection resources in efforts to collect them.[46] These unresolved cases have been deemed a low priority for work by ACS.[47]

On first glance, the IRS's decision to deem cases in the Queue a low work priority might seem reasonable, but an IRS cost effectiveness study (CES) found otherwise. This study was designed to assess the Private Debt Collection program by determining whether private collection agencies (PCAs) or ACS were more successful at collecting unpaid tax.

As part of the CES, ACS worked two groups of cases. One group was made up of Potential New Inventory (PNI) cases, which included cases from the Queue, shelved cases, and

44 The chart shows that in FY 2010, 40.8 percent of cases in the Queue were less than six months old; 10.5 percent of cases were between 6-9 months; 13.4 percent were between 10-15 months and 35.3 percent were 16 months and older. The mean (median) in FY 2010 was 46 cycles (weeks); in FY 2011 it was 39. The median range in both years was six to nine months. Collection Activity Report 5000-2. Due to business rules, *i.e.*, related cases, some cases involving less than $1,500 go directly to the CFf.

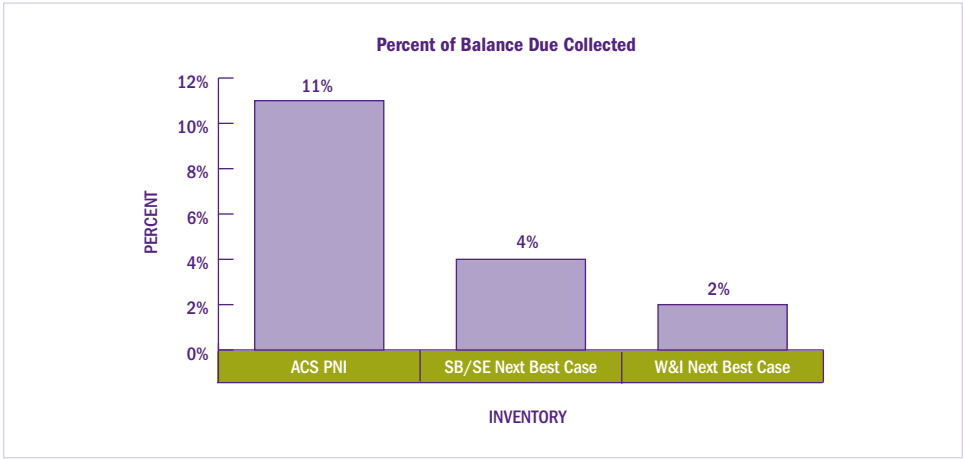
45 Collection Activity Report, NO-5000-2, Taxpayer Delinquent Account Cumulative Report (Sept. 2011).

46 *Id.*

47 The Queue is comprised of unresolved cases that are awaiting assignment depending on IRS resources and workload.

unable to locate and unable to contact cases, none of which were likely to be worked by IRS collection.[48] The second group included cases that were identified as those that ACS would work if it had more funding (*i.e.,* "next best case").[49] Although many of the PNI cases may have been "low dollar," ACS performed better at working PNI cases, which included inventory from the Queue, than working what it identified as its "next best case" inventory. More specifically, while ACS collected 11 percent of the balance due when working PNI inventory, it brought in just two percent of the balance due for W&I division next best case inventory and four percent for SB/SE next best case inventory.

FIGURE 1.21.4, ACS Percent of Balance Due Collection When Working PNI and Next Best Inventory



This study indicates that IRS business rules for determining which cases ACS should work may be flawed.

An additional concern regarding ACS case-assignment practices is illustrated by the fact that substantially more cases are transferred from ACS to the Queue by SB/SE ACS sites (which primarily work business accounts and those of self-employed taxpayers) than by W&I sites (which work accounts involving individual wage-earners.), indicating that ACS is much more effective at working the lower-dollar individual accounts. More specifically, in FY 2011 SB/SE sent 1.6 million TDAs to the Queue while W&I had to transfer only 178,000; in FY 2012 SB/SE transferred 1.07 million TDAs and W&I only 93,000.[50] This condition is yet another indicator that ACS is not focusing on the right types of cases (*i.e.*, smaller, wage-earner accounts), while spending Collection resources attempting to resolve

48 IRS Private Debt Collection-Cost Effectiveness Study (Mar. 2009). ACS worked cases similar to the types handled by PCAs, which were shelved, low priority, or unable to locate or contact cases with balances below $100,000.

49 There are ACS sites in both W&I and SB/SE. W&I ACS focuses on individual accounts, while SB/SE ACS focuses on business accounts.

50 IRS, CAR Report No. 5000-6 (Oct. 2, 2011, Sept. 30, 2012). See also Most Serious Problem: *The Diminishing Role of the Revenue Officer has been Detrimental to the Overall Effectiveness of IRS Collection Operations, supra.*

delinquency problems that could be more effectively addressed in the Collection Field function (BMF and self-employed taxpayers).

The National Taxpayer Advocate believes that working cases in order of the greatest balance due amount, rather than intervening early when the debts are fresh and amounts are modest, harms taxpayers, and impacts voluntary compliance. Since the IRS continues to significantly rely on dollar amounts for its case assignment practices, the cases with smaller liabilities continue to sit in the Queue and age. While the cases sit in the Queue, penalties and interest continue to accrue, making the liability larger and the case more difficult to resolve. By working the cases early when they involve smaller amounts, ACS could keep the accounts receivable from increasing while minimizing the damage to the taxpayer.[51] Therefore, the IRS should rethink its approach to prioritizing cases as a first step toward meeting the goals established in its Strategic Plan to "expedite and improve issue resolution" and to deliver "improved service to make voluntary compliance easier."[52]

ACS Should Work Defaulted Installment Agreements as a Priority.

When a taxpayer defaults on his or her installment agreement, the IRS sends the case back to ACS. Identifying these cases as prime candidates for outgoing calls, rather than working them like all other cases could help ACS achieve a better resolution and reduce potential harm to the taxpayer.

In addition to bringing the taxpayer back into compliance, making an outgoing call and reestablishing the installment agreement will yield more revenue. In FY 2012, over a quarter percent of all taxpayer delinquent accounts routed through ACS were reissued installment agreements, accounting for $8.7 billion in accounts receivable.[53] This condition indicates that having a personal contact with these taxpayers before placing the account in default status could reduce the risk of losing a significant amount of revenue, while also improving service for these taxpayers. A more proactive emphasis on curing default conditions earlier in the process would also reduce the amount of rework required by simply reassigning these accounts to ACS as "new" receipts.[54] Further, addressing missed payments as they occur to cure the potential default conditions will minimize penalty and interest accruals. The 1998 ACS Redesign project recommended a similar approach, stating that the IRS should focus on curing defaulted IAs through personal contacts.[55] This methodology is not without precedent; employees working under the Streamlined Offer in Compromise (OIC) process now call taxpayers for additional information rather than simply sending a letter requesting information. The results have been impressive.[56] The process has improved

51 See Most Serious Problem: *The Diminishing Role of the Revenue Officer has been Detrimental to the Overall Effectiveness of IRS Collection Operations*, *supra*, for a discussion on employment tax pyramiding and ACS.

52 IRS Strategic Plan 2009-2013.

53 Collection Activity Report, NO-5000-2, Taxpayer Delinquent Account Cumulative Report (Oct. 2012).

54 *Id.* Total TDAs Issued: 7,395,725 Issued from IA (Defaults): 1,853,051 (25.1 percent)

55 Automated Collection System (ACS) Redesign Project, *Working the Right Cases, at the Right Time, in the Right Way* (June 1998).

56 Collection Report C108 (Oct. 2012).

clarification of the issues, decreased cycle time, reduced rejects, and increased OIC acceptances. Although the streamlined OIC process is somewhat different from the installment agreement situation, we are confident the adoption of a similar approach that focuses on personal contact in ACS for lapsed installment agreements will produce similar results.

ACS Customer Satisfaction Surveys Do Not Present the Complete Picture.

Despite all the problems discussed above, the assessment of ACS service reflects high customer satisfaction and quality review scores. ACS's overall customer satisfaction ratings over the past six years (based on a scale of 1 thru 5, with 5 the highest score) have ranged from a low of 4.46 (2008) to a high of 4.51 (2005). FY 2011's rating was 4.50.[57]

However, TAS has concerns about how the survey is conducted. The IRS contracts with a survey administrator that develops sampling patterns and questions, and monitors call procedures. After an ACS employee speaks with the taxpayer, the ACS employee asks him or her to participate in the post-call survey, regardless of whether the issue has been resolved or not. However, only those who stay on the line until the end of the call are asked to be part of the survey.[58] Although statistically valid, the sample does not include ACS cases where an IRS employee never speaks to the taxpayer. It omits cases where ACS only sends out notices, such that the case may end up in the Queue, which may skew the results to more satisfied taxpayers.

Not only does the customer satisfaction survey exclude the majority of ACS taxpayers, namely, those who never speak to an ACS operator; the taxpayer is never asked if he or she believes the matter was resolved, let alone resolved satisfactorily.[59] Further, the SB/SE survey questions are more process-related and do not address the collection actions or their perceived or actual fairness. For example, the survey asks, "Rate your satisfaction with how well the automated answering system directed you to the correct representative."[60]

In contrast, TAS's customer satisfaction survey is a sample of closed cases within a given period, resulting in a more diverse sample population. TAS attempts to discuss the process and outcome of all cases, good and bad, with satisfied and unsatisfied customers.[61] We believe this approach provides more accurate information on how well TAS is meeting the expectations of its customers and the effectiveness of its procedures. One step ACS could take to obtain more accurate information would be to include questions that elicit the taxpayer's perception of how reasonably and fairly ACS handled the case.

57 Pacific Consulting Group, Internal Revenue Service Customer Satisfaction Ratings, Automated Collection System (ACS); SB/SE National Report Period July 10-June 11 Satisfaction Ratings (August 2011). W&I ACS had slightly higher scores ranging from 4.63 to 4.70. (This equated an overall satisfaction rating of 91 percent.)

58 *Id.* at Appendix A-2.

59 *Id.* Appendix C, C-35-C-40. The report indicated resolution partly 48 percent, and completely 36 percent (combined rate 84 percent).

60 Pacific Consulting ACS SBSE Appendix E-1.

61 ACS and TAS use the same contractor, Pacific Consulting Group.

CONCLUSION

The National Taxpayer Advocate believes that ACS continues to create problems for taxpayers and practitioners and is failing to resolve taxpayer cases. Part of this failure can be attributed to ACS relying on enforcement actions to make contact rather than placing outgoing calls to taxpayers early in the collection process. Additionally, taxpayers and practitioners continue to face long telephone wait times to respond to IRS actions. This can impede timely and fair resolution of collection problems. Finally, ACS may not be working the best cases, which is also limiting its success at resolving taxpayer issues.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Revise ACS collection strategy to use more outgoing calls prior to enforcement activity.
2. When ACS uses the predictive dialer, rather than simply leaving callback messages, as the current predictive dialer does, it should actually connect an answered call to a live assistor.
3. Once contact has been established, assign each ACS case to one employee, who will work with the taxpayer throughout the process.
4. Review and revise the Customer Satisfaction Measurement process in conjunction with TAS Research, revising the questions to elicit the taxpayer's perception of how reasonably and fairly ACS handled the case.
5. Develop a way to identify and review lapsed installment agreements and contact taxpayers prior to defaulting them.
6. Revise the Collection Strategy to send to ACS only cases that data has shown ACS can readily resolve, such as newer Queue cases, and place more emphasis on "initial contact" resolutions in making that determination.

IRS COMMENTS

Although it is not the only effective means of communicating with taxpayers, the IRS agrees that personal contact is an important part of assisting taxpayers to become compliant in both filing and paying their federal tax obligations. If a taxpayer responds to one of the many notices issued, our campus collection employees are helpful and efficient in resolving the account. If a taxpayer does not provide contact information or respond to the multiple notices issued, then the ACS must initiate the next most cost-effective action. We use a multi-faceted collection strategy to effectively maximize impact with available resources that includes the issuance of notices, levies, and direct contact with taxpayers.

To assist taxpayers with understanding their federal tax obligations, the IRS's Office of Taxpayer Correspondence (OTC) has worked closely with the Collection function on its notice redesign efforts over the last few years. The redesigned notices provide clearer, plainer language. The majority of collection notices were redesigned and implemented in January 2011 and improved engagement with the taxpayer through higher response

rates and liabilities collected earlier in the process (*e.g.*, installment agreements). The OTC comprehension and perception testing also showed an increase in understanding of notices by taxpayers.

The ACS is set up to get the taxpayers into the system as quickly as possible by sending them to the first available Collection Representative (CR) who can assist them, no matter where the assistor is located geographically in the country as opposed to waiting for a particular assistor to become available. Our employees pride themselves on providing the highest level of service to their taxpayers and attempt to resolve issues upon first contact.

The ACS program strives to balance focus between Customer Satisfaction, Customer Accuracy, and Productivity. In FY 2012, ACS handled approximately 4.9 million incoming calls and closed approximately three million taxpayer cases. The ACS has limited staffing resources, but strives to assist as many taxpayers as possible to resolve their accounts. In an effort to reduce taxpayer burden and reduce follow-up issues, we continue efforts that emphasize the need to resolve accounts on the first call. Examples include:

- Expansion of the streamlined installment agreement criteria, which is part of the Fresh Start Initiatives;
- Reduced documentation requirements for taxpayers to substantiate expenses on their financial statements;
- Revised Collection Information Statement to eliminate items that are not necessary to resolve the account and often delay case resolution while waiting on the taxpayer to secure and submit information; and
- Determination of which types of outcalls using the Predictive Dialer are more appropriate for unmanned campaigns.

Productivity is achieved through a focus on efficiency, which includes maximizing one-call resolutions and optimizing Average Handle Time[62] for the approximately five million incoming calls received by ACS annually. Our focus on efficiency includes the use of data analysis to best optimize the effective use of staffing resources to provide the opportunity to work with as many taxpayers as possible to resolve their accounts.

Performance data indicates ACS has achieved success with its focus on efficiency. The table below shows that, in spite of the decrease in resources, ACS continues to experience impressive improvements in efficiency and case resolutions, as reflected by taxpayer closures and the taxpayer closures per Full Time Equivalent (FTE), while remaining steady in Customer Satisfaction and Customer Accuracy performance.

62 ACS Average Handle Time refers to the total duration of the Aspect phone system talk time, hold time, and wrap time. Wrap time is the time used by the assistor to complete documentation of a call after the customer has been released.

FIGURE 1.21.5, ACS Performance Data

ACS Performance Data – Source ECR Report						
Performance Measure	Organization	FY 2010	FY 2011	FY 2012	% Diff 12/11	% Diff 12/10
ACS FTE	Enterprise	3,943	3,937	3,671	-6.8%	-6.9%
ACS Taxpayer Dispositions	Enterprise	2,537,558	2,710,163	2,724,721	.5%	7.4%
Per FTE rate	Enterprise	644	688	742	7.8%	15.2%
ACS Customer Satisfaction	Enterprise	92.6%	92.9%	92.0%	-1.0%	-0.7%
ACS Customer Accuracy	Enterprise	94.3%	94.9%	93.6%	-1.4%	-0.7%

Source: W&I PAC Report & SB/SE COBR Reports

The ACS's collection strategy places a strong focus on reaching out to taxpayers before taking enforcement actions. When a telephone number is not available, we strive to conduct research to obtain a valid and current number for the taxpayer. If a number is found, we make an attempt to reach the taxpayer through an outgoing call.

The ACS runs two types of Predictive Dialer (PD) campaigns:

- Manned – If the call is answered by a person, the call is transferred to an ACS Assistor or if an answering machine is reached, a message is left; and
- Unmanned – A message is left whether the call is answered by a person or an answering machine.

Manned campaigns represent 71 percent of ACS Dialer calls, of which contact is made on nine percent of the calls. The ACS designated PD sites have CRs staffed to handle calls when the PD reaches someone. On the calls where contact is made, 56 percent of the taxpayers reached have to call back with additional information.[63] On both manned and unmanned campaigns, 34 percent call back within 24 hours. We have made a determination of which outcalls are more appropriate for unmanned versus manned campaigns because data reflects that when we contact the taxpayer on a manned campaign, the taxpayer is usually not prepared to resolve the account, which requires the taxpayer to call back. Therefore, unmanned campaigns are run on cases where the final demand has been sent and ACS is making one last attempt to contact the taxpayer prior to enforcement action. Our use of both manned and unmanned PD campaigns is one of many examples showing we do not operate a "one size fits all issues" operation.

Over the years, ACS has evolved from an organizationally segmented processing approach (contact, research, and investigation) to a team approach that maximizes our resources in order to provide more efficient and effective service to taxpayers. Managing the ACS workload requires a balance between phones and inventory processing to achieve the best possible service to the maximum number of taxpayers. To assign each ACS case to one

63 ACS SB/SE Predictive Dialer Report, FY12.

employee to work through the process would adversely impact our ability to effectively manage corporately and present barriers in our efforts towards efficient resolution and effective service to our taxpayer base.

The delivery of ACS customer survey is the most effective means of securing feedback on the taxpayer's actual telephone experience. Completed in real time, thereby ensuring the timeliest, reliable, and accurate feedback, the survey is conducted and verified by an independent third party, Pacific Consulting Group. The PCG uses statistically valid sampling to ensure the survey is unbiased and representative of the ACS customer base. Survey questions encompass the entire experience, from the automated telephone routing system, to account processing questions, to numerous questions regarding the service provided by the actual collection representative who handled the call. The taxpayer is able to directly rate their overall satisfaction and indicate whether we met their expectations during their call. Key areas for improvement are identified through the survey. These areas are identified in the survey report as the *Top Improvement Priorities for ACS Customers* and *Top Improvement Priorities for Customer Service Representatives.* We concentrate on these key areas as we monitor call site performance.

Both W&I and SB/SE, in concert with Research and PCG, have worked to revise our surveys and the process used to capture information that provides meaningful insight to our performance in this area. Major changes were implemented in March 2012. Research also has significantly increased their involvement in providing analysis of the results and works closely with the operations in the identification of improvement priorities.

The IRS established a cross-functional team with the goal of helping taxpayers who were having difficulty maintaining their installment agreements. In February 2009, new procedures were established to contact individual taxpayers who were having trouble. When a taxpayer misses a monthly payment, a Letter 4458C is sent to inform the taxpayer that we did not receive a monthly payment and asks him or her to contact the IRS if he or she is having difficulty preserving their agreement. The IRM section 5.19.1.5.5 has been updated to reflect this change and includes directions for CRs to help the taxpayer maintain or reestablish their installment agreement.

The defaulted installment agreement issue is also an area that is scheduled to be addressed as a part of the PD outcall tests. We are working to identify installment agreement cases at the point of a missed payment and determine if we can initiate a PD outcall into the existing process. If successful, we will use the test to assess potential value that can be used in a cost benefit analysis to make system or resource changes. It should be noted that until there are changes made to the PD software and communication hardware, these cases will need to be brought into the ACS inventory.

The IRS continuously evaluates the collection strategy for case routing, selection, and prioritization. Many factors are considered during the evaluation process including the availability of resources to work cases and the most effective treatment. The IRS's Inventory

Delivery System (IDS) applies analytics to all cases routed through IDS that includes predictive models for collection potential. The results of this modeling are used by the IRS to prioritize inventory within ACS so optimal results are achieved given the limited resources to work cases. The business rules for routing cases to ACS take into consideration the authority and tools necessary to resolve each case. While some cases may not get fully resolved in ACS, there are benefits to ACS initially working the case instead of assigning directly to the collection queue. The IRS collects money and secures delinquent returns on many of these accounts while assigned to ACS. While the case is assigned to ACS, taxpayers may receive important information that can help them resolve their accounts.

The IRS agrees with the National Taxpayer Advocate about the importance of case resolution on initial contact. Policies and procedures guide employees to attempt resolution of a taxpayer case on first contact. Additionally, the IRS continues to explore using analytics earlier in the collection process that consider taxpayer behavior for establishing the most effective treatment stream.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS recognizes the importance of making personal contacts with taxpayers when attempting to resolve cases. However, the IRS's reluctance to acknowledge the need for improvements in ACS customer service and case prioritization is disappointing.

The National Taxpayer Advocate agrees that the clarity of IRS notices has improved over the past several years, but ACS relies too heavily on these notices to generate contact with the taxpayer. In fact, rather than making outgoing calls or sending a notice asking the taxpayer to call, which the IRS knows is effective, ACS heavily relies on generating phone calls from the taxpayer by sending out intent to levy or levy notices at the front end of the ACS treatment.[64] The IRS response continues to assume that this approach is both efficient and effective, but provides no evidence that it is either. In fact, the IRS's own studies discussed above suggest otherwise. Further, ACS's focus on enforcement type notices in the front end of the ACS treatment stream may actually be counter-productive for the IRS, as most ACS taxpayers did not self-correct during the initial collection notice process, and more of the same may actually discourage these taxpayers from coming forward to cooperate with the IRS to resolve the delinquencies. The National Taxpayer Advocate questions the effectiveness, as well as the efficiency, of this approach.

The National Taxpayer Advocate agrees that it is important to ensure that taxpayers spend as little time waiting for an ACS employee to take their call as possible; however, speaking to the same employee each time the taxpayer calls ACS will prevent the taxpayer from having to repeat the particulars of his or her case. In addition to designing an extension routing capability to allow the taxpayer to work with the same employee until the case is resolved, the IRS should also place more emphasis on routing cases to ACS that can be readily resolved with one phone call, thereby eliminating altogether the need for taxpayer call backs.

Although the IRS recognizes the important role ACS needs to play in the IRS "Fresh Start" initiative, there is little evidence that the initiative has been fully implemented. Contrary to what one would expect, the number of streamlined installment agreements (SLIAs) has decreased in FY 2012 when compared to FY 2011.[65] A decline in SLIAs is a symptom that ACS employees have not been properly trained on these new procedures, and are not focusing on "one-call" resolutions. The National Taxpayer Advocate is concerned that the IRS response does not seem to recognize that this unfortunate condition even exists.

64 Only about two percent of all ACS's time is spent making outgoing calls. Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-30-046, *More Management Information is Needed to Improve Oversight of Automated Collection System Outbound Calls* 6 (Apr. 28, 2010). *See also* National Taxpayer Advocate 2011 Annual Report to Congress 336-349 (Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*).

65 Collection Activity Report NO-5000-6, Installment Agreement Cumulative Report (Oct. 2012).

In regard to the ACS Performance Data, although dispositions may be slightly on the rise (up only one half of one percent) the volume transferred to the queue is significant. Specifically, in FY 2012, ACS transferred 1.17 million TDAs valued at $12.9 billion to the Queue.[66] Further, ACS's customer satisfaction numbers may appear impressive, but because the questions on the survey are narrow, they are not a complete reflection of the taxpayer's experience with ACS. Specifically, taxpayers are only asked about process and timeliness, not if they believe the matter was resolved, let alone resolved satisfactorily.

The National Taxpayer Advocate is pleased that the IRS established a cross-functional team with the goal of establishing procedures on how to reach out to taxpayers who were having difficulty maintaining their installment agreements. The new procedures focus on a new notice, Letter 4458C, *Second Installment Agreement Skip*, which is sent to inform the taxpayers that the IRS did not receive a monthly payment and asks them to contact the IRS if they are having difficulty meeting the terms of the agreement. However, the National Taxpayer Advocate believes these cases would be best addressed by outgoing phone calls to the taxpayers attempting to get them back into compliance, rather than simply sending letters, especially since good phone numbers should already be readily available in installment agreement cases. TAS commits to work with ACS to facilitate the use of the Predictive Dialer on such cases and the necessary programming so that these cases do not need to enter the regular ACS inventory.

The National Taxpayer Advocate does not contest that many taxpayers successfully resolve balance due cases during the notice process, and that ACS processing can provide resolution to many more. However, it is not clear that IRS is properly assigning to ACS the best cases to work (*i.e.*, cases that ACS can resolve quickly and efficiently). The IRS should use its analytics to better determine which cases are effectively resolved in the call-site environment, and which cases are not. Additionally, it is inappropriate to route certain types of cases, such as BMF and SB/SE Large Dollar cases, through ACS, especially when the change in case assignment is not supported by data and ACS employees are not trained to work such cases.

66 Collection Activity Report NO-5000-2, Taxpayer Delinquent Account Cumulative Report (Oct. 2012).

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Revise ACS collection strategy to use more outgoing calls prior to enforcement activity.
2. When ACS uses the predictive dialer, rather than simply leaving callback messages, as the current predictive dialer does, it should actually connect an answered call to a live assistor.
3. Once contact has been established, assign each ACS case to one employee, who will work with the taxpayer throughout the process.
4. Review and revise the Customer Satisfaction Measurement process in conjunction with TAS Research, revising the questions to elicit the taxpayer's perception of how reasonably and fairly ACS handled the case.
5. Develop a way to identify and review lapsed installment agreements and contact taxpayers prior to default.
6. Revise the Collection Strategy to send to ACS only cases that data has shown ACS can readily resolve, such as newer Queue cases or cases involving relatively low-dollar W&I taxpayers and place more emphasis on "initial contact" actions by making a measure for initial contact resolutions.

MSP #22

Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies are Clearly Supported by Either Increased Taxpayer Compliance or Revenue

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Farris Fink, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

Notices of Federal Tax Lien (NFTLs) establish the priority of the government's interest in a tax debtor's property against subsequent purchasers, secured creditors, and junior lien holders. TAS studies show that NFTLs can cause unnecessary harm to taxpayers and reduce their ability to become or remain compliant. They also generate significant downstream costs for the government, often without attaching to any tangible or intangible assets.[1]

In 2011, in response to the National Taxpayer Advocate's continued criticism of NFTL filing and withdrawal policies, the IRS announced a new effort to help financially struggling taxpayers get a "fresh start," which included several positive changes in how the IRS files and withdraws NFTLs. Notwithstanding this initiative, the IRS still files most NFTLs based on an arbitrary dollar threshold of the unpaid liability, rather than a thorough analysis of the taxpayer's individual circumstances and financial situation, or reference to NFTL impact on future compliance and collected revenue.

A recent Taxpayer Advocate Service (TAS) study found that by calendar year (CY) 2010, all taxpayers in the study with NFTLs filed against them owed 121 percent of what they owed when the lien was filed.[2] Taxpayers with NFTLs paid $25,845 on average, which is equivalent to about 69 percent of their liabilities at the time of lien filing. Non-lien taxpayers paid $38,477, equivalent to about 111 percent of their liabilities at the proxy lien date.[3] More importantly, taxpayers with whom the IRS agreed to settle debts through an offer in compromise (OIC) sometime before 2011 owed only 13 percent of what they owed at the lien or proxy lien date, while taxpayers who did not receive an OIC owed 123 percent of their individual IRS tax debts at the time of lien filing.[4] Further, taxpayers who entered into an installment agreement (IA) during the initial study years (*i.e.,* before 2005) paid

1 *See* T. Keith Fogg, Systemic *Problems with Low-Dollar Lien Filing*, 2011 TNT 194-9 (Oct. 6, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-128.

2 The study analyzes the impact of lien notice filing on taxpayer liabilities and payment behavior for a cohort of taxpayers who acquired liens between CYs 2002 and 2004. *See* TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*.

3 To compute a proxy lien filing date for our non-lien taxpayers, we first calculated the median days to lien filing from the date our lien taxpayers acquired their tax liability. For our non-lien taxpayers, we then added this number of days to the date they acquired their tax liability to determine the proxy lien filing date.

4 *See* TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.

significantly more on average than taxpayers who did not receive an IA.[5] Those with IAs owed only 57 percent of what they owed at the lien or proxy lien date, while taxpayers who did not receive an installment agreement owed 120 percent of what they owed at the lien or proxy lien date. Thus, NFTL filing produces less revenue and is more harmful to taxpayers than other collection alternatives.

As a result of this and other studies, the National Taxpayer Advocate has identified the following concerns with the IRS's NFTL policies, some of which have persisted for years:

- Low and inconsistent NFTL filing thresholds established under the "fresh start" initiative;
- The limited use of NFTL withdrawal authority;
- The IRS's inability to determine the impact of NFTLs on collected revenue due to the inadequate use of Designated Payment Codes (DPCs);
- Unnecessary harm to taxpayers whose accounts are reported currently not collectible (CNC) due to economic hardship; and
- The IRS's reluctance to develop meaningful NFTL filing and withdrawal criteria or use collection alternatives in lieu of lien filing, based on research on lien impact in terms of collected revenue and effect on tax compliance.

ANALYSIS OF PROBLEM

Background

With the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress recognized that federal tax liens may impose a serious hardship on taxpayers, and enacted provisions to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."[6] Enactment of RRA 98 likely led to reduced NFTL filing activity, as filings for fiscal year (FY) 1999 initially dropped to 168,000 compared to previous year averages of over 750,000.[7] Even though the law requires managerial approval for NFTL filings, "where appropriate," the IRS concluded that this approval was unnecessary for higher-graded employees.[8] By contrast, the IRS requires all employees to obtain managerial approval if they determine *not* to file or defer the filing of an NFTL when the case meets or exceeds the pre-determined threshold amount.[9]

5 Taxpayers who receive IAs before 2004 paid $ 44,989 on average towards their liabilities during the study period. Taxpayers who did not receive IAs paid $ 31,035 on average. *See* TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*.

6 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998). *See also* S. Rep. No. 105-174, at 78 (1998); Unanimous Consent Request – H.R. 2676, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

7 IRS, Statistics of Income (SOI), Table 16a, Delinquent Collection Activities, 2002-2009.

8 *See* RRA 98, Title III, § 3421; Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding section 3421 does not require supervisory review of all collection actions but allows the IRS discretion to determine where such review would be appropriate). Revenue Officers (ROs) at GS-9 and Automated Collection System (ACS) employees at the GS-6 level are authorized to file an NFTL without managerial approval. IRM 5.12.2.5 (Feb. 1, 2007); IRM 5.19.4.5.1(7) (Apr. 28, 2009).

9 IRM 5.12.2.4.2.3 (Mar. 8, 2012); IRM 5.19.4.5.2(10) (March 14, 2012).

The IRS based its NFTL filing model and policy on recommendations (now ten years old) noted in a Treasury Inspector General for Tax Administration (TIGTA) report.[10] The recommendations included filing NFTLs on currently not collectible accounts over $5,000 and on accounts placed in the Collection Queue.[11] In response to the report, the IRS took the position that in most cases, unless it filed the NFTL it was losing revenue, regardless of a taxpayer's inability to pay, the absence of assets to which the lien could attach, or the harm to the financial viability of the taxpayer. However, TAS has found that most payments for taxpayers with NFTLs filed against them for which TAS traced the source of the payment were attributable to sources other than the lien notice, *e.g.*, refund offsets.[12]

Despite its inability to measure how effective NFTLs are in collecting revenue, the IRS continued filing an increasing number of them.[13] The volume reached pre-FY 1996 levels again in FY 2008 when the IRS filed 768,000 NFTLs, and peaked at 1.1 million in FY 2010.[14] As a result of the Fresh Start changes in NFTL filing policies (discussed below), the number of NFTLs dropped about 32 percent to approximately 708,000 in FY 2012, as shown on Chart X below. Notably, IRS collection revenue did not decrease despite the significant drop in NFTLs filings.[15]

10 TIGTA, Ref. No. 2002-30-106, *The Internal Revenue Service Should Modify Its Federal Tax Lien Practices to Treat Taxpayers More Equitably and Better Protect the Government's Interest* (June 5, 2002).

11 The TIGTA report stated that the value of taxpayer assets should have no direct impact on a lien filing decision, and if the IRS does not file liens when accounts are closed CNC, the likelihood of any future collection is reduced. The queue is a holding process where cases are placed after the ACS system mails notices to taxpayers and before being assigned for additional collection action by the Collection Field function (CFf). Cases stay in the queue based on business rules and resources available to work them.

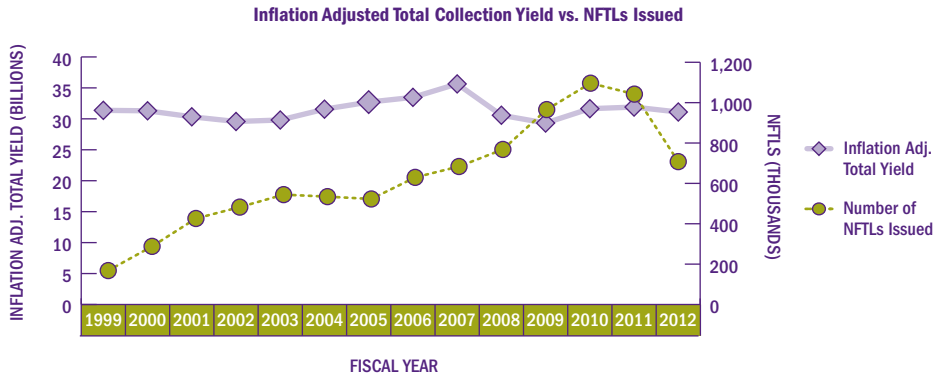
12 *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. TAS analysis of IRS payment source data found that the DPC was underutilized on post-assessment tax payments received in 2009. Thus, in most cases, the IRS does not know and cannot determine what event or action prompted the subsequent payment on a past due account.

13 The IRS does not adequately track the source of payments on past due accounts to measure the effectiveness of its collection actions. *See* National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

14 IRS, Statistics of Income (SOI), Table 16a, Delinquent Collection Activities, 2002-2009.

15 IRS Databook, FY 2012, Table 16.

FIGURE 1.22.1, Inflation-Adjusted Total Yield vs. NFTLs Issued in FYs 1999–2012[16]



Long-Lasting Effect of NFTL on Taxpayers' Financial Viability

The NFTL filing and the information contained in the notice are included in consumer (credit) reports[17] and therefore may impair a taxpayer's ability to obtain financing, find or keep a job, and secure affordable housing or insurance.[18] When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further damage his or her financial viability or impede recovery. Ultimately, the lien can undermine tax revenue and future compliance.[19]

TAS interviewed executives at the Experian, Equifax, and TransUnion credit bureaus about the long-lasting, damaging impact of NFTLs on credit reports.[20] While "paid tax liens" appear on credit reports for seven years from the date of payment,[21] unpaid liens may remain on the taxpayer's credit report indefinitely, even when the underlying lien becomes unenforceable (*e.g.*, because the statute of limitations for collection has expired and the

16 IRS, *IRS Data Book, Table 16, Delinquent Collection Activities, 1999-2012*; IRS, Collection Activity Report NO-5000-23 and 5000-25, *Collection Workload Indicators* (1999–2012).

17 The term "consumer report" is defined in the FCRA, § 603(d), 15 USC § 1681a(d). Hereinafter, we will use the more commonly used term "credit report." On average, the filing of an NFTL reduces a taxpayer's credit score by 100 points. Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

18 TAS teleconferences with the major consumer reporting agencies (CRAs) – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009). *See also* IRS Pub. 594, *What You Should Know About the IRS Collection Process* 4 (Apr. 2012) (recognizing the taxpayer may not be able to get a loan to buy a house or a car, get a new credit card, or sign a lease as result of the NFTL filing).

19 A further consequence of a lien's damage to a taxpayer's financial viability may be a need for unemployment benefits, food stamps, and the like, thus increasing societal cost.

20 National Taxpayer Advocate 2009 Annual Report to Congress 20.

21 The Fair Credit Reporting Act (FCRA), § 605(a)(3), 15 USC § 1681c(a)(3). *See also* Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the Fair Credit Reporting Act, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be noted on the credit report but does not necessarily impact the credit score in a significant way.

lien self-released).[22] In addition, the filing of a NFTL reduces a taxpayer's credit score by an average of 100 points.[23] Thus, the filing may hamper collection and damage the interest that the government intends to protect.

The IRS does not sufficiently consider the impact of an NFTL on credit reports or the resulting harm to the taxpayer. The IRM states that "[t]he filing of a NFTL may affect a taxpayer's credit rating, and this alone is not sufficient reason to withhold filing the NFTL."[24] Given changes in credit reporting practices and the use of credit reports, the IRS should routinely consider the impact of NFTLs on taxpayers' credit before NFTL filing.

The Fresh Start Initiative Has Reduced the Number of NFTL Filings and Increased the Number of Withdrawals.

For several years, the National Taxpayer Advocate has expressed concerns about the adverse impact of IRS lien filing and withdrawal policies on taxpayers and future compliance.[25] TAS also completed several comprehensive studies of the impact of NFTLs on taxpayer compliance behavior, which showed that indiscriminate filings might negatively influence revenue collection.[26] In response, the IRS issued guidance designed to help financially struggling taxpayers, including several positive changes in how it files and withdraws NFTLs.[27] TAS worked very closely with the Collection function in developing and clearing procedural guidance related to the "Fresh Start" initiative,[28] which included:

- Doubling the dollar threshold for filing most NFTLs from $5,000 to $10,000, resulting in fewer NFTLs;[29]
- Changing procedures for NFTL withdrawals after lien releases;[30]

22 As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years and Equifax for ten years, while Transunion credit reports reflect them indefinitely. Self-releasing liens are generally reported for ten years after the filing date unless the lien is refiled by the IRS. California requires that all liens, released and open, be removed from credit histories ten years after the filing date. *See* Cal. Civ. Code § 1785.13(d).

23 Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

24 IRM 5.12.2.4.2(6) (Mar. 8, 2012).

25 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 109-128; National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. *See also* TADs 2010-1 and 2010-2 (Jan. 20, 2010). For copies of the TADs, *see* National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, *available at* http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf.

26 *See TAS Research Study: Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior, vol. 2, infra.* *See* also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

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

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

29 SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0311-039 (Mar. 28, 2011). The Collection Process Study (CPS), in which TAS actively participated, recommended raising the threshold to $50,000. IRS, CPS 122 (Sept. 30, 2010). NFTLs can still be filed for any amount if appropriate. IRM 5.12.2.4.1 (Mar. 8, 2012).

30 SB/SE, *Interim Guidance Memorandum*, Control No. SB/SE-05-0611-037 (June 10, 2011).

- Providing for NFTL withdrawal in most cases where a taxpayer enters into a Direct Debit Installment Agreement (DDIA);[31] and
- Eliminating NFTL filings when the balance to be reflected on the NFTL is less than $2,500.[32]

Following up on these changes, the IRS reprogrammed its Automated Collection System (ACS),[33] which files NFTLs systemically, as follows:

- On February 24, 2011, ACS's systemic NFTL filing threshold was increased from $5,000 to $10,000;
- On April 15, 2011, the threshold was further increased to $25,000; and
- On June 25, 2011, ACS established a systemic lien 'floor' amount, on subsequent tax periods at $2,500 or more.[34]

The Effect of the Fresh Start Initiative on the Number of NFTLs Filed

Because of these changes, in FY 2011 the number of NFTLs decreased by approximately 54,000 or five percent from FY 2010 levels.[35] In FY 2012, the trend continued with NFTL filings down about 32 percent from FY 2011. Automated Collection System filings dropped by 48 percent and filings by Revenue Officers (or non-ACS NFTLs) dropped by 19 percent, as shown on Figure 1.22.2 below.

31 SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0411-036 (Apr. 7,2011).

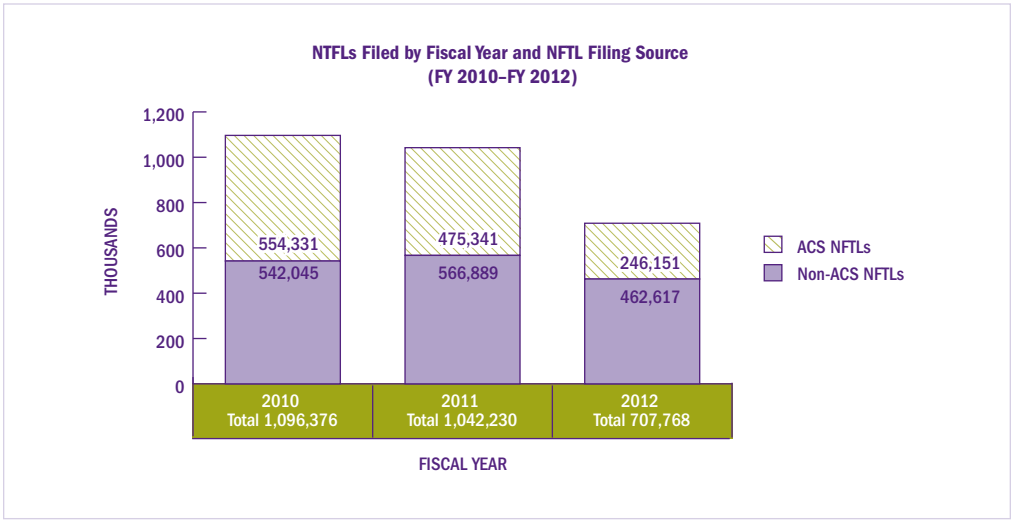
32 SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0511-050 (May 13, 2011).

33 IRMs for both Revenue Officers (ROs) and ACS generally state that the NFTL may be filed if the unpaid balance of assessment is $10,000 or more. IRM 5.12.2.4.1 (Mar. 8, 2012); IRM 5.19.4.5.2 (Mar. 14, 2012).

34 IRS response to TAS information request (Oct. 1, 2012).

35 IRS, Collection Activity Report NO-5000-23, *Collection Workload Indicators (Oct. 30, 2011); IRS, Fiscal Year 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

FIGURE 1.22.2, NFTLs Filed by Fiscal Year and NFTL Filing Source, FY 2010–2012[36]



Although it filed fewer NFTLs, the IRS continued to file most NFTLs based on inconsistent dollar thresholds of liability for ACS and ROs, without meaningful human review of the need for the NFTL based on the facts and circumstances of the case.

Fresh Start changes in NFTL filing thresholds provide the IRS an opportunity to measure the change, by sampling accounts to determine the revenue impact of filing NFTLs at the higher thresholds. The earliest IRM guidance made available to TAS (issued around 1978) did not contain a specific dollar threshold requiring an NFTL filing.[37] Instead, the Revenue Officer was to use his or her best judgment in determining whether an NFTL should be filed.[38] The IRM established the $5,000 threshold for manager's approval not to file an NFTL, which was tantamount to a filing threshold and equals $17,667 in today's dollars.[39] If the IRS wanted to reduce taxpayer burden by doubling the dollar amount, the effective value of that $10,000 would now be $35,334, still short of the $50,000 threshold recommended for a pilot study of applying new NFTL filing criteria by the IRS's recent Collection Process Study.[40] Thus, the revised lien policies may not deliver the promised "fresh start" for many taxpayers who will grapple with the burden of NFTLs for years.

36 IRS, Collection Activity Report NO-5000-25 (Oct. 1, 2012). The number of Non-ACS NFTLs includes refiled lien notices.

37 Archival IRM 5424.11(1), 5424.11(2), 5424.11(3), 5424.12(1), 5424.12(2), 5424.12(3), 5426(1)(a) (Apr. 14, 1978).

38 *Id.* The IRM referenced a $2000 amount as the transfer threshold of the account to the field, when no personal or telephone contact was made for an NFTL filing determination.

39 U.S. Dept. of Labor, Bureau of Labor Statistics, Consumer Price Index (CPI) Inflation Calculator, 1978 vs. 2012. *See also* IRS response to TAS information request (Oct. 1, 2012) (citing archival IRM 5426(1)(a) (Apr. 14, 1978) as earliest notation of the $5000 filing threshold).

40 IRS, *Collection Process Study* (CPS) 122 (Sept. 30, 2010)

The Effect of the Fresh Start Initiative on NFTL Withdrawals

The "Fresh Start" initiative increased the IRS's use of NFTL withdrawals, especially in cases where the underlying lien has been released.[41] Form 10916(c), *Withdrawal of Filed Notice of Federal Tax Lien*, is filed in the jurisdiction where the IRS originally filed the NFTL, indicating that the IRS has formally withdrawn the notice, and leading to removal of the NFTL from the public record.[42] This step helps improve taxpayers' financial viability by repairing their credit ratings.[43]

In FY 2011, the IRS began allowing individual taxpayers to more readily obtain NFTL withdrawals upon entering into direct debit installment agreements (DDIA) to resolve tax debts of $25,000 or less, when the debt will be paid within 60 months (or prior to the Collection Statute Expiration Date (CSED), whichever comes first).[44] The IRS also agreed that generally it would withdraw NFTLs where tax liabilities have been fully satisfied, even when the NFTLs have already been released.[45]

Through the end of FY 2012, thousands of financially struggling taxpayers have successfully obtained NFTL withdrawals to help regain their financial viability, as shown on Figure 1.22.3 below.[46] Withdrawals increased from about 4,700 in FY 2010 to almost 8,700 in FY 2011 and about 12,000 in FY 2012. Of these, 2,285 in FY 2011 and 4,550 in FY 2012 were NFTL withdrawals after lien releases.[47]

41 *See* SB/SE, *Interim Guidance Memorandum*, Control No. SB/SE-05-0312-029 (March 12, 2012) and IRM 5.12.3.29 & 30 (May, 31, 2012); SB/SE, *Interim Guidance Memorandum*, Control No. SB/SE-05-0611-037 (June 10, 2011); SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0411-036 (Apr. 7,2011). This guidance was issued in response to TADs 2010-1 and 2010-2. *See also* National Taxpayer Advocate FY 2012 Objectives Report to Congress 12.

42 For NFTL withdrawal criteria, see IRC§ 6323(j)(1)(A)-(D). The underlying statutory lien may remain in effect if the account is not satisfied. *See* generally IRC §§ 6321; 6322.

43 Without the NFTL withdrawal, in full paid cases, the fact of NFTL filing will stay on credit reports for seven years. FCRA, § 605(a)(3), 15 USC § 1681c(a)(3). As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years and Equifax for ten years, while Transunion credit reports reflect them indefinitely. Self-releasing liens are generally reported for ten years after the filing date unless the lien is refiled by the IRS. TAS teleconferences with the major CRAs – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009).

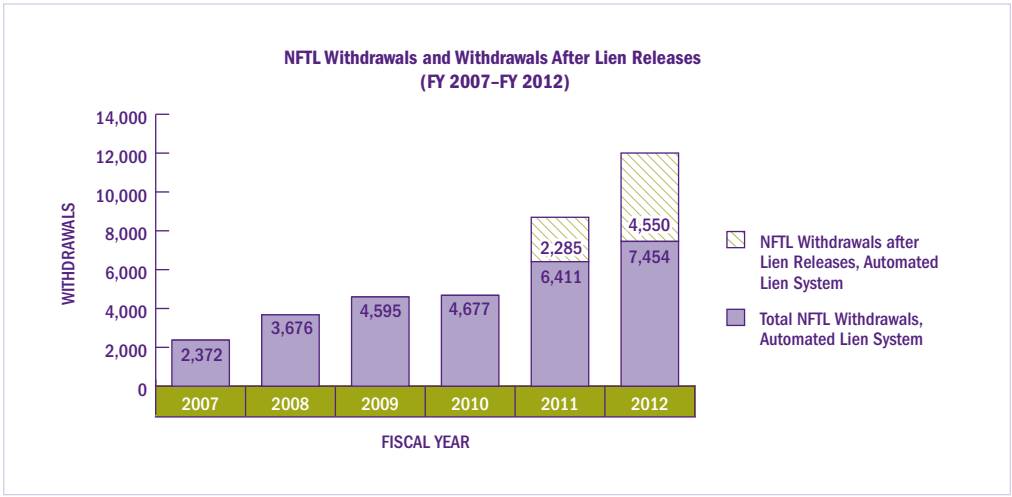
44 IRS, SBSE-05-0411-036, *Withdrawal of Notice of Federal Tax Lien in Direct Debit Installment Agreement Situations* (Apr. 7, 2011).

45 IRS, SBSE-05-0611-037, *Withdrawal of Notice of Federal Tax Lien after Release* (June 10, 2012).

46 IRS Collection Activity Report, NO 5000-25 (Oct. 22, 2012). *See also* IRS response to TAS information request (Aug, 15, 2012). After the "fresh start" guidance was released, NFTL withdrawals increased almost twofold in FY 2011, and almost threefold in FY 2012, compared to FY 2010 levels.

47 IRS, Automated Lien System, Total NFTL Withdrawals and Withdrawals after Lien Releases, FYs 2007-2012.

FIGURE 1.22.3, The Number of NFTL Withdrawals and Withdrawals After Lien Releases in FY 2007–2012[48]



However, despite the positive impact of the Fresh Start policy changes, only 80 employees in the IRS Office of Advisory and Insolvency (AI) worked NFTL withdrawal requests.[49] This means the number of taxpayers who can benefit from these new policies remains relatively small. The IRS should expand the NFTL withdrawal authority to all ROs and to appropriate ACS employees.

The IRS Still Lacks Tools to Determine the Revenue Effectiveness of NFTLs.

The National Taxpayer Advocate remains concerned about the IRS's inability to determine the impact of NFTLs on collected revenue due to the inadequate use of Designated Payment Codes (DPCs) to identify the source of post-assessment tax payments on past due accounts.[50] The IRS enters DPCs for payments attributable to collection actions such as liens, levies, offers in compromise and installment agreements.[51] A TAS analysis of IRS payment source data found the DPC was underutilized on post-assessment payments received in 2009.[52] Thus, in most cases, the IRS does not know and cannot determine what event or action prompted the subsequent payment on a past-due account.

The IRS has not acted on the National Taxpayer Advocate's recommendation to link each subsequent payment to specific IRS enforcement activities and service initiatives.[53] A recent TIGTA audit also concluded the IRS does not consistently or accurately apply DPCs,

48 IRS, Automated Lien System, Total NFTL Withdrawals and Withdrawals after Lien Releases, FYs 2007-2012.

49 IRS response to TAS information request (Aug. 15, 2012).

50 In prior research, TAS found that most payments for lien taxpayers were attributable to sources other than the lien, *e.g.*, refund offsets. *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. *See also* National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

51 IRM 3.8.45.9.1 (Feb. 1, 2009).

52 National Taxpayer Advocate 2010 Annual Report to Congress 250-266. Even with transaction codes that require DPCs, about 75 percent of all entries either had no DPC or defaulted to DPCs of "00" (undesignated payment) or "99" (miscellaneous).

53 For a detailed discussion of designated payment codes, see National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

which reduces its ability to assess the effectiveness of collection actions and may lead to inefficient use of resources as well as unnecessary burden on compliant taxpayers.[54] TIGTA recommended that the IRS establish a DPC for all primary payment actions and for all transaction codes (TCs) for payments made in direct response to NFTL filings. The IRS should include TAS in its ongoing review of DPCs, which it agreed to complete by April 15, 2013.[55]

DPCs provide a way to track taxpayer behavior and future compliance, but are ineffective when the IRS does not consistently apply the codes to all subsequent payments. Measuring NFTL effectiveness by using meaningful DPCs and TCs would give the IRS a more accurate and complete picture of whether NFTLs cause the taxpayer to pay on a balance due account. Then the IRS can also factor in costs associated with these filings to complete the cost-benefit analysis.[56] For example, if after attempting to personally contact a taxpayer, the IRS files an NFTL and the taxpayer enters into an installment agreement that permits an NFTL withdrawal under the "fresh start" procedures, it would be logical to attribute the payments to the NFTL filing because the lien has facilitated collection. But if the IRS files the NFTL automatically with no prior personal contact with the taxpayer, and the liability is subsequently paid by a refund offset, it cannot be reasonably associated with the NFTL because there is no direct causal effect between the filing and the payment. The offset would occur with or without an NFTL.

IRS Lien Policy Continues to Harm CNC Taxpayers Experiencing a Hardship.

While NFTL filing is decreasing overall, the IRS retains the requirement of automatic filing on all accounts closed as CNC if the dollar amount of the liability exceeds the $10,000 threshold.[57] The IRS requires employees to secure managerial approval for the *non-filing* of an NFTL in any situation where the unpaid balance of assessments exceeds $10,000.[58] The National Taxpayer Advocate continues to disagree with this policy. As noted in a prior report, 59 percent of the total collected on these CNC taxpayer accounts comes from refund offsets, which occur with or without the filing of an NFTL. Only 20 percent of the funds collected on these accounts are attributable to NFTLs.[59] The automatic filing of an NFTL

54 TIGTA, Ref. No. 2012-30-02, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

55 This review was initiated in response to the 2010 Annual Report to Congress. *See* National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

56 The IRS estimates that an NFTL filing costs between $25 and $100 plus labor costs. IRS Collection Process Study (CPS) 122 (Sept. 30, 2010). The IRS may spend up to $109 million in lien filing costs annually, not including labor costs, based on 1,096,376 NFTLs filed in FY 2010. IRS, Fiscal Year 2010 Enforcement Results, *available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

57 IRM 5.16.1.1 (May 22, 2012). IRS Policy Statement P-5-71 provides the IRS authority to report an account as currently not collectible (CNC) for a variety of reasons (*e.g.*, unable to pay (hardship), unable to contact or locate, and death). "Economic hardship" occurs when an individual taxpayer is unable to pay reasonable basic living expenses. *See* Treas. Reg. § 301.6343-1(b)(4). The tax is not forgiven, only placed in non-collection status. Penalties and interest continue to accrue, and the accounts may be subject to refund offset.

58 IRM 5.12.2.4.2.3 (1) (Mar. 8, 2012).

59 *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Study: *The IRS's Use of Notices of Federal Tax Lien*). For those CNC taxpayers who had payment transactions, only 20 percent of the funds collected were attributable to NFTLs. However, this information cannot be inferred to the total population of CNC taxpayers. TAS study notes that 67 percent of the payment transactions had a "miscellaneous" DPC or the DPC was missing. As a result, it is impossible to identify what IRS action resulted in a payment on the delinquent account. In other words, only 33 percent of payment transactions used a DPC that gave a descriptive indication of what IRS action may have triggered the payment.

on a CNC account can worsen the taxpayer's already proven hardship without increasing revenue collection.[60]

The IRS could replace the mandatory NFTL filing on CNC taxpayers and taxpayers with no assets with a system of subsequent filing determinations based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved, using information from Accurint and IRS internal databases. This type of analysis is not without precedent. The IRS allows employees to refile an NFTL following extension of the collection statute expiration date using their judgment rather than an arbitrary threshold amount.[61] In fact, the IRS instructs employees *not to automatically* refile the NFTL.[62] The IRS employee must analyze each individual taxpayer's present and future assets before refiling an NFTL.[63] If the Revenue Officer can make this determination on a refiled NFTL, both ROs and ACS employees should be authorized to use the same procedure for the original determination of NFTL filing.

TAS's Multiyear Comprehensive Study of NFTL Impact on Future Compliance and Revenue Demonstrates the Need for Meaningful NFTL Filing and Withdrawal Criteria Based on Financial Risk Scoring Principles.

In FYs 2009-2012, TAS Research & Analysis investigated the IRS's use of NFTLs and their impact on the compliance behavior of delinquent taxpayers.[64] For tax year (TY) 2009, TAS's analysis of NFTL filing practices showed NFTLs were responsible for only $2 of every $10 in payments collected from taxpayers in CNC (Unable to Pay - Hardship) status,[65] while nearly $6 of every $10 collected from these taxpayers came from refund offsets.[66] Nonetheless, the IRS filed NFTLs against more than 72 percent of CNC taxpayers suffering

60 The IRS filed nearly 1.1 million NFTLs in FY 2010, an increase of about 550 percent from FY 1999, while the total dollars collected (adjusted for inflation) actually declined by about seven percent from $29.4 billion to $27.2 billion (in terms of real dollars valued as of 2009). IRS, Fiscal Year 2010 Enforcement Results, *available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. IRS, Statistics of Income (SOI) Data Books, Table 16, Delinquent Collection Activities, 1999-2009. *See also* Bureau of Labor Statistics, Dept. of Labor, Consumer Price Index – All Urban Consumers (CPI-U), *available at* http://www.bls.gov/CPI/.

61 Upon the collection statute expiration date, the liability secured by lien becomes legally unenforceable. *See* generally IRC §§ 6325(a)(1); 6502(a). The NFTL contains the self-releasing language that extinguishes the NFTL and underlying statutory lien. *See* Form 668(Y)(c), *Notice of Federal Tax Lien* (Rev. Feb. 2004). If the collection statute is extended or suspended on the underlying assessment, beyond the ten-year period, the NFTL must be refiled in the original jurisdiction to keep its priority back to the original filing date. *See* IRC § 6323(g).

62 IRM 5.12.2.20.1(3) (Oct. 30, 2009).

63 *Id*.

64 *See* TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact on Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2010 Annual Report to Congress, Vol. 2, 89-100. *See also* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

65 *See* IRM 5.19.1.7.1.5 (Sept. 7, 2011); Policy Statement P-5-71, IRM 1.2.14.1.14 (Nov. 19, 1980). *See also* IRM 5.16.1.1 (May. 22, 2012) and IRM 5.16.1.2.9 (May 22, 2012). The basis for a hardship determination is from information about the taxpayer's financial condition provided on Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Form 433-B, *Collection Information Statement for Businesses*. *See also* IRM 5.15.1, Financial Analysis Handbook (Oct. 2, 2012).

66 The IRS automatically moves (offsets) refundable overpayment credits from one period to others with liabilities in the taxpayers' accounts. IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction File Cycle 200913. *See also* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18.

an economic hardship in tax year (TY) 2009.[67] These practices harm taxpayers who are experiencing economic hardship and do not lead to any ascertainable revenue gains.

The results of the 2012 TAS study show that NFTL filings during the study period (CYs 2002-2010) had a negative effect on the payment behavior and liabilities of affected taxpayers.[68] Taxpayers with NFTLs filed against them generally paid less and ended up owing more than non-lien taxpayers:

- Taxpayers with NFTLs paid an average of $25,845, or about 69 percent of their total individual liability at the time of lien filing. Non-lien taxpayers paid $38,477, equivalent to about 111 percent of their total individual liability at the proxy lien date.
- At the end of the study period (CY 2010), taxpayers with NFTLs owed 21 percent more on average than they owed when the lien was filed (they incurred their original liabilities in 2002). Non-lien taxpayers owed 11 percent more than they owed on their total individual liability at the proxy lien date.[69]

Significantly, TAS's most recent study also found that CNC taxpayers suffering an economic hardship with an NFTL owed more both at the beginning and at the end of the study period than any other category of taxpayers, as shown in table 1.22.1 below.

TABLE 1.22.4, Taxpayer Liabilities When the Lien Was Filed vs. CY 2010

	Mean Balance at Lien or Proxy Lien Date	Mean Balance 2010	Ratio 2010/ Lien Date
All Lien Taxpayers	$37,486	$45,314	1.21
All Taxpayers without Liens	$34,813	$38,635	1.11
CNC Hardship Taxpayers with Liens	$55,475	$83,263	1.50
CNC Hardship Taxpayers without Liens	$27,800	$42,403	1.53

In general, when taxpayers in the study were able to obtain either an offer in compromise (OIC) or an installment agreement (IA), they owed less in CY 2010 than they owed when the lien was filed. As Table XX shows below, taxpayers in the study who had OICs accepted sometime between CY 2002 and CY 2010 owed only 13 percent of what they originally owed at the lien or proxy lien date. On the other hand, taxpayers who did not receive an OIC owed 123 percent of what they originally owed at the lien or proxy lien date. Thus, the OIC plays a crucial role in helping taxpayers escape an endless cycle of growing tax indebtedness.

67 National Taxpayer Advocate 2009 Annual Report to Congress 17-40.

68 *See* TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*.

69 *See id.*

TABLE 1.22.5, OIC/No-OIC Taxpayer Liabilities When the Lien Was Filed vs. CY 2010

	Mean Balance When the Lien Was Filed	Mean Balance 2010	Ratio 2010/ 2002
OIC	$68,917	$8,763	0.13
No OIC	$35,106	$43,032	1.23

Based on preliminary results from this new study, the IRS should not only develop NFTL filing determination criteria based on the impact of NFTL filing on taxpayers in general, on those in CNC status, and on potential improved compliance measures for the remaining lien taxpayers, but should also actively promote the use of collection alternatives such as OICs and IAs in lieu of NFTL filings.[70] TAS suggests that the IRS take innovative new approaches to NFTL filing and withdrawals, using the financial risk scoring that has become standard in the banking and financial industries.[71] A risk-scoring algorithm can employ objective factors such as the existence and value of the taxpayer's equity in assets, compliance history, reasons for noncompliance, effect on credit score and collection potential, possible harm to the taxpayer and his or her ability to comply in the future, willingness to resolve the liability, payment before the collection statute expiration date (CSED), etc. When the score exceeds a set threshold, the algorithm would be supplemented by human review in the final decision about whether to file. This human review would incorporate an analysis of the taxpayer's potential eligibility for collection alternatives such as OICs and IAs. The IRS needs to train its employees how to make qualitative judgments of the taxpayers' financial circumstances before determining whether to file an NFTL and proactively offer OICs and IAs as alternatives to NFTL filing. In this way, the IRS will collect more revenue even as it reduces economic harm to taxpayers.

CONCLUSION

While the National Taxpayer Advocate recognizes the positive impact of the Fresh Start initiative, she remains concerned about the IRS's reluctance to eliminate automatic NFTL filing based on arbitrarily set thresholds. The IRS should also develop precise payment coding to account for subsequent payments received because of NFTL filings, so it has better data to determine objective criteria for NFTL filing. Without accurate coding, studies of lien effectiveness will not provide empiric results. TAS offers its assistance in studying the impact of NFTL filings on CNC taxpayers and developing a risk-scoring algorithm for

70 *See Introduction to Collection Issues: The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes, supra. See also* Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload, infra/supra*; Most Serious Problem: *Early Intervention, Offers-in-Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance, infra/supra*.

71 See generally Experian, *Financial Stability Risk Score*, *at* http://www.experian.com/business-information/financial-stability-risk-score.html; Rosella, *Credit Risk Analysis and Modeling*, *at* http://www.roselladb.com/credit-risk-analysis.htm.

meaningful NFTL filing and withdrawal determinations, and in the development of guidance to employees for considering collection alternatives other than NFTL filing.

RECOMMENDATIONS

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Include TAS in the ongoing review of DPCs initiated in response to the National Taxpayer Advocate and TIGTA reports.
2. In consultation with TAS and IRS Research functions, revise current DPCs and TCs to categorize each subsequent payment to a filed NFTL.
3. Collaborate with the National Taxpayer Advocate and TAS Research on the ongoing SB/SE lien study of the effectiveness of NFTLs in CNC situations and in the next phase of the TAS lien study on using NFTLs to best improve future compliance.
4. In collaboration with the National Taxpayer Advocate, develop a risk-scoring algorithm based on thorough review of objective factors, discussed above.
5. Replace the current IRS policy of automatically filing NFTLs based on a dollar threshold of the unpaid tax liability with NFTL filing determinations based on the risk-scoring algorithm and develop training for all Collection employees on the new qualitative determination procedures, including the use of collection alternatives such as OICs and IAs in lieu of NFTL filings.
6. Immediately increase the NFTL filing threshold to $50,000, both for ACS and ROs, as recommended by the IRS Collection Process Study.
7. Immediately replace the mandatory NFTL filing on CNC-hardship taxpayers and taxpayers with no assets with a system of subsequent filing determinations based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved.
8. Require managerial approval for NFTL filing in cases involving CNC (Unable to Pay-Hardship) taxpayers.
9. Expand NFTL withdrawal authority to all ROs and ACS employees who are authorized to file NFTLs.

IRS COMMENTS

The IRS is committed to assisting taxpayers with their voluntary filing and payment responsibilities. In setting policy, we are charged with balancing the interests of taxpayers with our responsibility to protect both the government and the American taxpaying public's interests when those taxes are not paid. The Federal Tax Lien is critical for the IRS to protect these interests. The FTL exists by operation of law after an assessment has been made, a demand for payment of the debt has been made, and the taxpayer has neglected or

refused to pay. The lien attaches to the current and future assets owned by the taxpayer. It remains in effect until the tax debt is paid or becomes unenforceable.

A Notice of Federal Tax Lien must be publicly filed to put the taxpayer's current and future creditors on notice of the debt owed by the taxpayer and to establish the priority of the NFTL among other secured creditors. The decision to file an NFTL does not mean the IRS is taking possession of any assets or depriving the taxpayer of the use of the assets. The filing of the NFTL does not eliminate any avenues available for the taxpayer to resolve their debt, but it protects the government's interest in collection processes. Since the lien itself attaches to current and future assets, an NFTL may be filed even though the taxpayer has no current assets, or specific assets have not been identified. The IRS recognizes that filing an NFTL can impact the taxpayer's credit rating so the taxpayer is first afforded the opportunity to resolve the debt. Then, before determining whether to file an NFTL, other factors are considered including the taxpayer's willingness and ability to pay the debt and the amount owed. IRS employees also have discretion to not file an NFTL if it would hamper collection of the taxes owed, there is doubt as to the liability, or forthcoming information could lead to either of the above. The collection process is constructed so that a cooperating taxpayer can resolve their debt without an NFTL being filed.

As noted by the National Taxpayer Advocate, the IRS has made several changes within the last two years to its NFTL filing policies, specifically with regard to the NFTL filing thresholds and NFTL withdrawals including:

- Doubling the dollar threshold for filing most NFTLs from $5,000 to $10,000, resulting in fewer NFTLs;
- Changing procedures for NFTL withdrawals after lien releases;
- Providing for NFTL withdrawal in most cases where a taxpayer enters into a Direct Debit Installment Agreement; and
- Setting the minimum NFTL filing threshold at $2,500.

The National Taxpayer Advocate was provided the opportunity to review all of these changes prior to implementation, and their participation was a significant part of the review process. We appreciate that the National Taxpayer Advocate values the changes we have made to update our NFTL program. We believe that these changes have significantly benefited taxpayers.

The Most Serious Problem includes views on the NFTL program and questions aspects such as the NFTL filing criteria and the general effectiveness of the NFTL. Much of the discussion relies on a new 2012 research study conducted by the TAS Research & Analysis function that the IRS has not had sufficient time to thoroughly review. However, based on our initial review of the study's methodology, we believe that to properly consider the usefulness of the study conclusions, additional information or a better understanding on the

population size and the propensity score model would be necessary. We look forward to analyzing this issue in more detail.

After reviewing a 2011 TAS study, we expressed concerns that the underlying data, formulas, and methodologies did not support the findings without additional research. Because of questions about the data, we cannot comment on the conclusions that taxpayers against whom the IRS has filed an NFTL tend to be less compliant in tax filing and payment in subsequent tax years. In addition, we also note that the practitioner article cited in the MSP appears not to be an additional study, but an article which is partially based on the results of the 2011 TAS research study.

The IRS has also conducted NFTL research studies which have been shared with TAS. One study concluded that NFTL filing has a direct impact on resolution; has the potential to increase full and partial resolution for both Individual Master File (IMF) and Business Master File (BMF) cases in the queue; and, for BMF entities with one to five employment tax modules, has the most likelihood to pay the greatest proportion of their balance. Both TAS and IRS research found that filing NFTLs on currently not collectable hardship taxpayers appears beneficial to the government as the IRS collected more dollars from CNC hardship taxpayers with an NFTL filed rather than when one has not been filed.

The IRS does acknowledge that NFTL filings do have inherent costs associated with them, and those costs are monitored. The recent IRS decision to raise the NFTL threshold and set a minimum NFTL filing criteria of $2,500 was due in part to IRS trying to balance the administrative costs of collecting. The IRS is unlike a private sector creditor who can extend or deny credit to a person based on a risk analysis. The private sector practice to secure debts is the routine filing of a note or judgment against the debtor. In the case of the IRS, filing lien notices to establish creditor standing is the only legal means the IRS has to protect the interest of the United States.

The National Taxpayer Advocate further suggests that the dollar threshold used for filing NFTLs should be higher and/or not utilized at all proposing a risk-based algorithm be employed instead. The use of filing thresholds initially came into use to address a concern about consistent treatment of taxpayers. Even so, the amount a taxpayer may owe is not the only determining factor for filing an NFTL. In certain IA situations, a filing determination is not required. Also, instructions to staff allow flexibility to not file or defer filing the NFTL based on the case facts. Risk-based algorithms are utilized by financial institutions to determine to whom money should be loaned. Their algorithms may be based on the person's credit rating, their previous loan history, income, and other factors to determine the risk of the person defaulting on the loan. Once a person owes a tax liability, the government's interest is already at risk. Because the government does not select its customers, the required analysis is necessarily different.

Generally speaking, a taxpayer is given several opportunities to resolve his or her debt before an NFTL is filed. The amount the taxpayer owes is but one factor in determining

whether to file an NFTL. Prior to the recent increase in the dollar amount threshold, much consideration was given to the appropriate amount, including an inflationary adjustment from the enactment of the prior threshold. Although the basic threshold of $10,000 was established for all collection functions, programming for NFTLs routinely filed by the Automated Collection System was set at a higher amount. The National Taxpayer Advocate refers to the difference in programming as an inconsistent policy. However, this programming was implemented to provide additional relief to taxpayers during the current economic crisis. Since the majority of cases flow through ACS before being assigned to Field Collection, the heightened ACS programming level provides additional time for taxpayers to resolve their liability and additional flexibility for field officers to work with taxpayers before filing an NFTL.

In the MSP, the National Taxpayer Advocate suggests the NFTL does not produce revenue and continues to use Designated Payment Codes to evaluate the effectiveness of filed NFTLs while at the same time acknowledging that DPCs are not an accurate source (*See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18). The DPCs are intended to identify payments received from a specific collection event (*e.g.,* levy, seizure), or for a specific taxpayer-defined action (e.g., paying trust fund taxes, paying toward an OIC). A DPC cannot presume the taxpayer's motivation for making a payment nor can it attribute multiple factors to individual credits on a taxpayer's account. A taxpayer's reason for taking any actions regarding a federal tax debt can be based on any number of reasons that are directly or indirectly attributable to the NFTL. To credit the influence of the NFTL only to those payments with DPCs specifically notated as lien-related does not provide a complete picture as the FTL exists whenever a tax debt is owed, and the NFTL, or potential for it, is always present. For example, taxpayer actions such as paying the liability in full, making installment payments, or filing an offer in compromise, may be motivated by the anticipation of, as well as the utilization of, the NFTL. So, while movement can be made with the DPC application to better track the most immediate event leading to the payment, DPCs can never capture the total impact of the NFTL effectiveness as essentially every collection action can be attributed, at least in part, to the NFTL. We are presently analyzing the utilization of DPC codes to determine their usefulness and will involve TAS in any implemented changes to DPCs and their usage. The IRS recognizes the importance of properly determining the effectiveness of the NFTL and value of the appropriate selection of DPCs; however, measuring and reporting on trends in collection activity and dollars collected through DPCs would fail to account for other variables critical to analyzing the effectiveness of collection actions. Additionally using DPCs related to the filing of an NFTL to measure and report trends in collection activity and dollars collected is limited because of the inherent limitations in DPC data.

In making conclusions on the revenue produced by NFTLs and promoting IAs and OICs as alternatives to filing NFTLs, the MSP relies on the TAS 2012 research study. In our preliminary review of the study's methodology, we noted that it does not provide the number of IA or OIC cases that had NFTLs filed compared to the number that did not. There is also

no distinction between the IAs where an NFTL filing determination was not required from the higher risk IAs where a filing determination had to be made. Moreover, the findings that taxpayers who have IAs pay more than those who do not and that taxpayers who have accepted OICs owe less than those who do not are conclusions having limited bearing on the effectiveness of NFTL filings.

The National Taxpayer Advocate also makes a conclusion on the effectiveness of the NFTL by drawing comparisons between increased NFTL filings and decreased dollars collected by Collection. We do not believe a direct correlation between the sets has been demonstrated. It should also be noted that the decrease in overall collection revenue is discussed without regard to factors such as the recent economic downturn.

Finally, the National Taxpayer Advocate continues promoting the withdrawal of the NFTL for taxpayers as a way to make them more compliant. The IRS has made changes to the NFTL withdrawal policy allowing more taxpayers to qualify for withdrawals; however, the IRS is not aware of data to determine the immediate or long-term effect of this change on future collection and compliance. The MSP report suggests the number of IRS employees working NFTL withdrawals is a hindrance; however, we are not aware of any data indicating NFTL withdrawal requests have been repressed or not been processed based on our current staffing. The IRS's recent expansion of positions authorized to approve NFTL withdrawals in certain circumstances will further facilitate the timeliness of working NFTL withdrawals, but this should have no impact on the volume of requests received.

The research of the NFTL CNC situations has been completed and the results previously shared with TAS. Discussions continue on collaborating with continued research in this area. We look forward to TAS affording us the opportunity to participate in the parameters and methodology stage with any future TAS research studies regarding NFTLs.

As discussed, the IRS is unlike a private-sector creditor who can extend or deny credit based on a risk scoring algorithm. Given that the debt has already been incurred (in essence the credit extended), there is limited benefit to using that model as a determinate for a notice of lien filing. Many factors come into play before an NFTL filing decision is made. IRS employees have discretion to not file a NFTL if it will hamper collection of the taxes owed, there is doubt as to the liability, or forthcoming information could lead to either of the above. The taxpayer's filing and payment compliance, along with their financial viability, are considered when the non-filing or deferring of a notice of Federal Tax Lien is being determined. Additionally an NFTL determination is not required on Guaranteed/ Streamlined Installment Agreements or In-Business Trust Fund Express Agreements, but NFTLs may be filed at the discretion of the revenue officer to protect the government's interest (such as a pending bankruptcy or other exigent circumstances). TAS has been, and continues to be, an integral part of the review process when the IRS sets policy regarding factors impacting NFTL determinations and filing.

Instructions to staff are updated when NFTL policy changes are made. NFTL issues have been, and remain, a regular part of the yearly Collection training cadre of topics. Collection remedies such as OICs and IAs are an integral part of the collection process, not necessarily an "alternative" to filing an NFTL. Recent changes affording the taxpayer the ability to have the NFTL "withdrawn" provide the taxpayer additional alternatives and incentives to resolving tax liabilities.

As discussed, the IRS recently raised the lien filing threshold. We will continue to monitor whether additional changes are appropriate. Further increasing the thresholds would require a comprehensive risk-based analysis of the impact in order to avoid a negative impact on collection for the government. Both GAO and TIGTA have commented that the IRS needs to adequately protect the government's interest in regards to delinquent taxes. The IRS is currently developing and implementing statistical analyses to observe the influence of the Fresh Start lien filing threshold increase relative to other factors.

An NFTL filing does not prevent the taxpayer from obtaining financing to acquire assets. Multiple reviews to determine if the taxpayer has acquired assets on which the government has already lost the opportunity of being a secured creditor is not an effective way to protect the government's interest. Additional reviews revisiting NFTL filing decisions would add significant costs while relying on arbitrary timeframes for performing the subsequent reviews, neither of which is efficient or effective. A taxpayer who has acquired assets may file bankruptcy and the government claim will not be protected. However, a taxpayer can contact the IRS to discuss payment alternatives at any time.

The IRS has determined appropriate levels for managerial approval of NFTL filing and under what conditions approval is needed. The TAS and IRS research both concluded that IRS collected more dollars with CNC hardship taxpayers when an NFTL is filed than when one has not been filed.

The delegated authority to approve an NFTL withdrawal was expanded, with the concurrence of TAS, in May 2012 to certain positions outside Advisory and Insolvency management, based on situational factors. Procedures for the expanded authority should be implemented by spring, 2013.

Taxpayer Advocate Service Comments

For four consecutive years, the National Taxpayer Advocate has addressed the IRS's lien-filing practices as one of the most serious problems facing America's taxpayers.[72] During this time, TAS has also produced several detailed and enlightening research studies to assist the IRS in adjusting these practices in a manner that is beneficial to the government, our taxpayers, and the goal of voluntary compliance.[73] In light of the extensive dialogue that has already taken place regarding this issue, the National Taxpayer Advocate finds the IRS's response to this report to be disappointing.

The IRS has once again fallen back on a mantra-like position that its current lien-filing practices are "critical" to "protect the interests of the government and the American taxpaying public," without adequately explaining why and how this is the case. That rote justification can be used to justify any policy, no matter how ineffective or harmful. The response takes the position that "the IRS does not select its customers" in justifying why best practices used by most financial institutions do not apply to delinquent taxpayers. Yet, the response fails to recognize that "voluntary compliance" is a long-term commitment for most taxpayers, and collection treatments that focus only on short-term results can be counterproductive to the long-term objectives of sound tax administration.[74]

The IRS response reveals a continued lack of appreciation and concern by the IRS for the financially devastating impact a Notice of Federal Tax Lien can have on a financially struggling taxpayer. The IRS's response also implies a general lack of understanding of its own collection policies and procedures. The IRS contends that before determining whether to file an NFTL, it considers other factors, including the taxpayer's willingness to pay the debt. The IRS further states the collection process is "constructed so that a cooperating taxpayer can resolve their debt without an NFTL." These statements are misleading and essentially inaccurate.

The Internal Revenue Manual requires Collection employees to make a lien-filing determination within ten days from the "initial attempted contact or initial actual contact date, whichever date is earlier." A determination is still required within ten days even if no contact has been made with the taxpayer.[75] In establishing criteria for making this determination, the IRM clearly specifies that if the taxpayer's "unpaid balance of assessments is

72 *See* National Taxpayer Advocate 2011 Annual Report to Congress 109-128;National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. *See also* TADs 2010-1 and 2010-2 (Jan. 20, 2010).

73 *See Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

74 For a detailed discussion of this issue, see TAS Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, vol. 2, *infra*.

75 IRM 5.12.2.4 (Mar. 8, 2012).

$10,000 or more," then the employee is required to file a lien.[76] This guidance is very clear, and creates an environment where collection employees can generally file NFTLs before making any contact with the affected taxpayers.

We appreciate the IRS's acknowledgement of TAS's involvement in the development of the changes in lien policies included in the "Fresh Start" initiative. We are pleased that the IRS recognizes TAS as an integral part of the policy review process. However, over the past year, TAS has worked extensively with the IRS to expand its lien-filing criteria to allow more flexibility and judgment by Collection employees in determining when an NFTL is actually necessary. Certainly, the taxpayer's level of cooperation should be one of these factors. Yet, in far too many cases, it is not. TAS has not been able to clear recent IRM revisions pertaining to IRS lien-filing practices, and we appear to have reached an impasse on this issue. The National Taxpayer Advocate continues to urge the IRS to develop lien-filing criteria that reasonably balance the necessity of an NFTL to collect delinquent taxes against the financial harm the lien creates for many taxpayers.

In January 2010, the National Taxpayer Advocate issued a Taxpayer Advocate Directive regarding the IRS's lien-filing practices. In response, the IRS committed to conduct a study to specifically determine the utility of filing NFTLs on CNC hardship accounts, and examine the effect of lien filings on cases with no assets. This response, issued in June 2010, specified that this study should include the input of TAS Research and was to be completed as "expeditiously as possible." Despite IRS comments to the contrary, no such comprehensive study has been completed to date. The IRS response indicates that "research studies" have been completed that confirm the benefits of current lien-filing practices. However, TAS has found these studies to be exceptionally limited in scope, and inconclusive in identifying the impact of the NFTL on revenue collection and the subsequent compliance behavior of the affected taxpayers.

In its response, the IRS states that "TAS and IRS research both concluded that IRS collected more dollars with CNC hardship taxpayers when an NFTL is filed than when one has not been filed." The IRS bases this statement on findings of a recent research study it conducted that TAS found to be so fundamentally flawed in its analysis and conclusions that the National Taxpayer Advocate secured the agreement of the IRS Director of Research and the Commissioner of SB/SE to not publicize this study and to collaborate with TAS on better-designed research in this area. She sought that agreement because she was concerned

[76] IRM 5.12.4.1 (Mar. 8, 2012). The IRM notes that taxpayers who enter into certain types of installment agreements with the IRS, *e.g.* "streamlined" agreements, generally will not be subject to a lien. However, if the NFTL is filed prior to making contact with the taxpayer, this opportunity is lost.

that the IRS would use the unsupported findings of this study to justify taxpayer-harmful policies. The IRS's response confirms her fears.[77]

After citing a research study that IRS leaders agreed was flawed, the IRS response ironically expresses concerns that TAS's research studies cannot be considered conclusive without additional research. Moreover, the IRS states that in order to determine the impact of the recent changes to the lien-filing thresholds, "a comprehensive risk-based analysis" must be completed to "avoid a negative impact on collection for the government."[78] The National Taxpayer Advocate has consistently supported the use of comprehensive, ongoing research to support important business decisions, and has conducted and publicly reported on significant research studies, including one in volume 2 of this report regarding the impact of lien filings on amounts collected and owed by debtor taxpayers. Moreover, TAS Research usually shares not only the final results of our research studies with the appropriate IRS research functions, but also shares our design for the studies before we actually conduct the data runs.

There comes a time when the IRS's demand for "comprehensive analysis" begins to sound like a stalling tactic to avoid making prudent business decisions. The IRS has had ample time to produce meaningful data to support its lien-filing practices, but has failed to do so. In the meantime, thousands of taxpayers continue to suffer the consequences of indiscriminate filing of NFTLs.

77 The IRS (SB/SE Research) did not determine whether any revenue was collected from real estate sales or bankruptcy proceedings, whether the taxpayers were still in CNC status at the time of the proceedings, or whether the proceeds (if any) were applied to the CNC modules the IRS filed the liens against. The IRS also did not adequately confirm whether real estate was actually purchased. It could have been inherited or previously owned – a judgmental verification sample in Accurint showed that their methodology for identifying real estate ownership was likely not accurate: of the 20 taxpayers sampled, Accurint confirmed real estate ownership in only 12 cases (60 percent). The IRS also did not determine whether the taxpayer still had a tax liability at the time the real estate was purportedly purchased.

78 In its response, the IRS states that "the National Taxpayer Advocate suggests the NFTL does not produce revenue and continues to use Designated Payment Codes to evaluate the effectiveness of filed NFTLs while at the same time acknowledging that DPCs are not an accurate source." The IRS has mischaracterized the results of our 2009 lien study. In that study, we found that the IRS, contrary to its own IRM provisions, had failed to input meaningful DPCs on 67 percent of the 1,886,683 payments made by taxpayers during the study period. Many payments had a null (00) or miscellaneous (99) DPC coding. Thus, because of the IRS's failure to follow its own procedures, TAS was unable to report on the connection between liens and *all* payments. However, TAS was able to track and report on the connection between liens and *those payments for which the IRS had input a DPC or were coded as refund offsets*. The data on those 912,249 payments conclusively showed that 95 percent of the payments and 80 percent of the dollars paid were not attributable to the filing of a notice of federal tax lien. *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Include TAS in the ongoing review of DPCs initiated in response to the National Taxpayer Advocate and TIGTA reports.
2. In consultation with TAS and IRS Research functions, revise current DPCs and TCs to categorize each subsequent payment to a filed NFTL, where applicable.
3. Collaborate with the National Taxpayer Advocate and TAS Research on the ongoing SB/SE lien study of the effectiveness of NFTLs in CNC situations and in the next phase of the TAS lien study on using NFTLs to best improve future compliance.
4. In collaboration with the National Taxpayer Advocate, develop a risk-scoring algorithm based on thorough review of objective factors, discussed above.
5. Replace the current IRS policy of automatically filing NFTLs based on a dollar threshold of the unpaid tax liability with NFTL filing determinations based on the risk-scoring algorithm, and develop training for all Collection employees on the new qualitative determination procedures, including the use of collection alternatives such as OICs and IAs in lieu of NFTL filings.
6. Immediately increase the NFTL filing threshold to $50,000, both for ACS and ROs, as recommended by the IRS Collection Process Study.
7. Immediately replace the mandatory NFTL filing on CNC-hardship taxpayers and taxpayers with no assets with a system of subsequent filing determinations based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved.
8. Require managerial approval for NFTL filing in cases involving CNC (Unable to Pay-Hardship) taxpayers and cases in which no personal contact has been made with the taxpayers.
9. Expand NFTL withdrawal authority to all ROs and ACS employees who are authorized to file NFTLs.

MSP #23

Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance

RESPONSIBLE OFFICIAL

Faris Fink, Commissioner, Small Business/Self-Employed Division
Carol Campbell, Director, Return Preparer Office

DEFINITION OF PROBLEM

Payroll service providers (PSPs) play an important role in tax compliance by helping employers navigate and follow increasingly complex employment tax laws, and freeing them to focus on their core business purposes.[1] When a PSP goes out of business or misappropriates its clients' funds, the employers remain liable for the unpaid payroll taxes. Each PSP failure can result in grave financial harm to multiple clients that may be required to pay the amount of payroll taxes twice, once to the PSPs and again to the IRS, along with interest and penalties.[2] Some small businesses may be unable to recover from these setbacks and may be forced to cease operations and lay off their employees.

Despite a number of PSP failures over the last five years, leaving thousands of employers with hundreds of millions of dollars in unpaid employment taxes, the IRS has not publicized its Effective Tax Administration (ETA) offer in compromise (OIC) authority as a viable collection alternative and has consistently underutilized offers to provide relief to victims.[3] The number of accepted non-economic hardship (NEH) ETA OICs ranged between 21 and 45 during each of the past five years, with only 28 offers accepted during the last full fiscal year (FY) 2012.[4]

For nearly a decade, the National Taxpayer Advocate has voiced concerns about the compliance problems and significant financial burden on taxpayers associated with PSP and other third-party payer failures.[5] Although we commend the IRS for making significant progress

1 IRS data show that paid preparers submitted 34.6 percent of Forms 940, 941, 943, and 944 returns in the last full tax year 2011. However, the number is likely substantially higher. IRS, Compliance Data Warehouse (CDW), Business Return Tax File Table (Oct. 2012).

2 *See, e.g.*, Internal Revenue Code (IRC) §§ 6656(a) and 6672(a).

3 Between FY 2007 and FY 2012 (to date), as a result of the IRS's recommendations, the Department of Justice (DOJ) criminally prosecuted at least 24 owners and operators of different types of third-party payers who collected about $300 million in employment taxes from their client employers and did not pay them over to the Treasury. IRS, Employment Tax Fraud, Case Examples, FY 2007–FY 2012. One payroll company's executives embezzled about $1.3 million from about 3,000 clients across the country. The Morning Call, *Two Easton-area Men Stole Nearly $1.3 million from New Jersey Payroll Company* (Oct. 24, 2011). Another payroll company's bankruptcy left about 1,500 clients with unpaid employment taxes. The Washington Post, *The Culprit Could Be Dead, But Local Tax Case Lives On* (Oct. 13, 2008).

4 IRS responses to TAS information requests (June 29, 2012 and Oct. 22, 2012).

5 *See e.g.*, Hearing Before the H. Comm. on Small Business, 112th Cong., 1st Sess. (Apr. 13, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2007 Annual Report to Congress 337-354 (Most Serious Problem: *Third Party Payers*).

in addressing the issues identified in previous Annual Reports to Congress, serious problems persist, including:

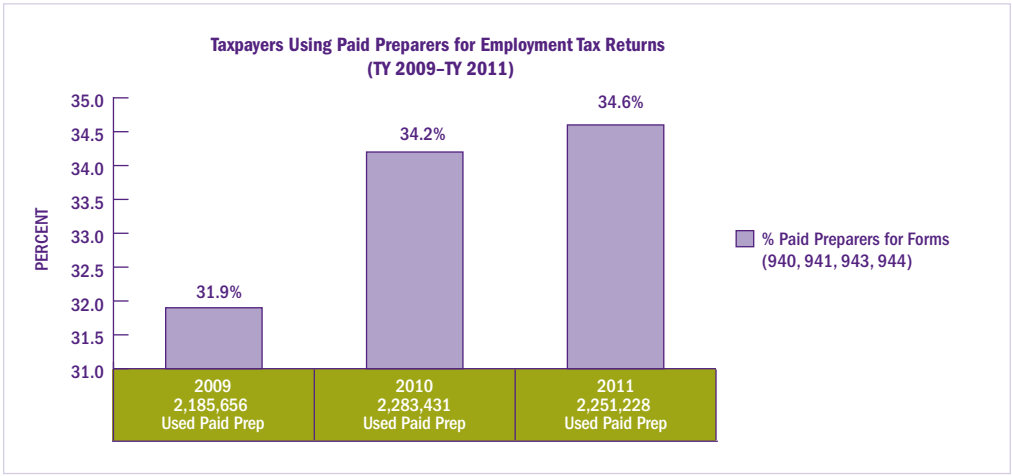
- The absence of early detection and timely intervention in PSP delinquencies that compound problems for victims of PSP failures;
- Ambiguous policies and procedures that limit the use of ETA OICs as a viable collection alternative for victims of PSP failures; and
- Ineffective communications and outreach to taxpayers about the risks inherent in outsourcing payroll tax obligations and steps they can take to mitigate those risks.

ANALYSIS OF PROBLEM

Background

The complexity of employment tax compliance poses a financial and administrative burden for small business owners leading many to outsource their payroll to third parties.[6] One study indicates that in 2012, about 85 percent of small businesses sampled paid an external tax practitioner or accountant to handle their tax responsibilities, while about 41 percent hired a PSP to prepare and pay their payroll taxes.[7] IRS data show that a growing number of taxpayers used paid preparers for employment tax returns in tax years (TYs) 2009-2011, as depicted in Figure 1.23.1 below.

FIGURE 1.23.1. Taxpayers' Usage of Paid Preparers for Employment Tax Returns in TYs 2009–2011[8]



6 For a detailed description of third-party payer arrangements, see National Taxpayer Advocate 2007 Annual Report to Congress 339 (Table 1.22.1, *Third Party Arrangements*). *See also* IRS, Publication 4019, *Third Party Authorizations, and Levels of Authority* (May. 2012), the original version of which the IRS developed in collaboration with TAS.

7 National Small Business Association, *2012 Small Business Taxation Survey* (Apr. 2012). PSPs that are members of the National Payroll Reporting Consortium (NPRC) represent over 1.4 million employers with over 35 million employees, exceeding one-third of the private-sector workforce. See http://www.nprc-inc.org/about.html (last visited Oct. 20, 2011).

8 IRS, CDW, Business Return Tax File Table (Oct. 2012). We considered a taxpayer to be using a paid preparer if a paid preparer completed at least one quarterly or annual return for the taxpayer. PSPs that are members of the NPRC represent over 1.4 million employers with over 35 million employees, exceeding one-third of the private-sector workforce. *See* http://www.nprc-inc.org/about.html (last visited Oct. 20, 2011).

In the more than 65 years since the enactment of the IRC Subtitle C, *Employment Taxes*, the payroll industry has originated various types of third-party payer (TPP) arrangements for reporting, filing, and paying employment taxes, which include PSPs, aggregate filers (Form 2678 Agents),[9] reporting agents (RAs) (Form 8655 Agents),[10] and Professional Employer Organizations (PEOs).[11] This discussion is limited to PSPs.

A PSP is a third party paid by an employer to administer the employer's payroll and employment tax responsibilities, including one or more of the following:

- Prepare paychecks for employees;
- Prepare employment tax returns using the employer's Employer Identification Number (EIN);[12]
- File employment tax returns for the employer, which are signed by the employer;
- Make federal tax deposits (FTDs) and federal tax payments (FTPs) and submit this information for the taxes reported on the employment tax returns; and
- Prepare Form(s) W-3 and Form(s) W-2 for the employees using the employer's EIN.[13]

An employer's use of a PSP does not relieve the employer of its employment tax obligations or liability.[14] Unlike some other TPPs, PSPs are not liable for an employer's portion of employment taxes either as employer or agent.[15] Employment tax non-compliance by a PSP may result in delinquent client accounts.[16] While most PSPs are legitimate and trustworthy companies, a few "bad actors" have defrauded their clients and tarnished the image of the

9 These agents are also commonly referred to as "IRC § 3504 agents" that can file employment tax returns of their clients under their own EIN. IRC § 3504 agents report, deposit, and pay the employment taxes of their clients under the agent's EIN. Both the § 3504 agent and the employer are liable for the employer's employment taxes while the agent authorization is in effect. *See* IRC § 3504; Rev. Proc. 70-6, 1970-1 C.B. 420; Form 2678, *Employer/Payer Appointment of Agent*.

10 *See* Rev. Proc. 2012-32, 2012-34 I.R.B. 267. Reporting agents report and deposit employment taxes on behalf of their clients. A reporting agent assumes no liability for the clients' employment tax withholding, reporting, payment, or filing duties. IRS, *Third Party Arrangements, available at* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Third-Party-Arrangements (last visited Oct. 30, 2012).

11 A PEO, sometimes referred to as employee leasing company, enters into an agreement with a client to provide employees to perform services for the client, pay compensation to the employees, and assume responsibility to collect, report, and pay employment taxes under the EIN of the PEO. A PEO may represent to a client that the PEO is the employer of the workers providing services to the client. IRM 5.1.24.6 (Aug. 15, 2012). *See also* IRM 5.1.24-1 (Aug. 15, 2012); IRS, *Third Party Arrangements*, available at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Third-Party-Arrangements (last visited on Sept. 9, 2012).

12 Employment tax returns generally include Form 94X series.

13 IRM 5.1.24.4.2 (Aug. 15, 2012).

14 Employers that pay wages for services of an employee are generally required to deduct and withhold Social Security, Medicare, and income taxes from the wages. See generally IRC §§ 3102(a), 3121(a), and 3402(a).

15 Employers are also responsible for unemployment tax (FUTA) and their share of the Social Security and Medicare tax for their employees. *See* generally IRC §§ 3301, 3111(a) and (b), 3306(b).

16 *See, e.g.*, IRM 5.1.24.5.1(2) (Aug. 15, 2012).

industry.[17] Between FY 2007 and FY 2012, as a result of the IRS's recommendations, the DOJ criminally prosecuted at least 24 owners and operators of different types of third-party payers who collected about $300 million in employment taxes from thousands of client employers and did not pay them over to the Treasury.[18]

The IRS has Made Significant Progress in Addressing Third-Party Payer Failures.

The National Taxpayer Advocate commends the IRS for actions taken in collaboration with TAS during past five years, which include:[19]

- The Small Business Self Employed (SB/SE) division's study of the TPP program;[20]
- The new IRM section describing TPP arrangements for employment taxes, and providing collection approaches to employers that are victims of TPP misappropriation, including penalty abatement and collection alternatives;
- Modification of the Reasonable Cause Assistant (RCA) to allow abatement of penalties if the taxpayer can prove timely and full payment of employment taxes to the TPP;[21]
- Designation of PSP/PEO Coordinators in each Collection Area to act as liaisons for the coordination of PSP and other third-party payer issues;[22]
- Development of training for revenue officers on recognizing and working cases involving TPPs;[23] and
- Issuance of guidance for assessment of the Trust Fund Recovery Penalty (TFRP) against third-party payers, including responsible parties within a PSP or a PEO.[24]

Despite these efforts, serious problems remain.

17 For example, during the first quarter of 2011, one payroll service provider in Pennsylvania filed for bankruptcy after failing to deposit $4.1 million on behalf of its 300 clients. SB/SE Research Study: *EFTPS Program, Requirements Change Notice for EFTPS – Final Report, Executive Summary and Recommendations* (Apr. 24, 2012). Other payroll company executives embezzled about $1.3 million from about 3,000 clients across the country. The Morning Call, *Two Easton-area men stole nearly $1.3 million from New Jersey payroll company* (Oct. 24, 2011). *See also* U.S. Dept. of Justice Press Release, *Payroll Service Provider Indicted for Tax Evasion, Failing to Pay Employment Taxes* (July 19, 2012) (discussing Siham Solutions, Inc., a payroll service company, which had numerous clients, including home health care providers).

18 IRS, Employment Tax Fraud, Case Examples, FY 2010 – FY 2012, *available at* http://www.irs.gov (last visited Sept. 11, 2012). *See also* National Taxpayer Advocate 2009 Annual Report to Congress 270-271.

19 Acting upon recommendations in the 2007 Annual Report to Congress, the IRS established a joint task force with TAS to work on third-party payer failures in spring 2008. *See* National Taxpayer Advocate 2007 Annual Report to Congress 337-354 (Most Serious Problem: *Third Party Payers*).

20 SB/SE Study, Program Review of Third Party Payers (undated); IRS response to TAS information request (Aug. 26, 2012).

21 IRM 5.1.24.5.5.1 (Aug. 15, 2012).

22 IRM 5.1.24.5.1 (Aug. 15, 2012).

23 SB/SE CPE Training Module (FY 2012), Third Party Payer Arrangements for Employment Taxes; IRS response to TAS information request (Aug. 26, 2012).

24 *See* IRM 5.7.3.3.3 (July 19, 2012); SB/SE, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer*, SBSE-05-0711-044 (July 1, 2011). This guidance is consistent with a 2004 legislative recommendation by the National Taxpayer Advocate. National Taxpayer Advocate 2004 Annual Report to Congress 394-399. Individuals who have willfully failed to pay the trust fund portion of delinquent employment taxes may be subject to the TFRP. IRC § 6672. Trust fund taxes are the income tax, Social Security, and Medicare taxes employers withhold from their employees' wages.

Early Detection of PSP Noncompliance and Timely Intervention Can Improve Compliance and Alleviate Financial Burden on Victims of PSP Failures.

Early intervention is key to protecting affected employers from PSP failures and preventing the accumulation of substantial employment tax liabilities, as well as minimizing revenue loss to the federal government. Early intervention includes education and outreach, and is aimed at "touching" the taxpayer as soon as possible after the IRS detects a delinquency. While the IRS has an interest in collecting taxes, businesses also benefit by not accumulating substantial unpaid payroll taxes and avoiding the associated penalties and interest. Over time, unpaid balances may compound beyond a business's ability to pay and ultimately cause financial jeopardy.

Tracking Employer-PSP Relationships Would Allow the IRS to Intervene Before Victims Accumulate Substantial Payroll Tax Balances.

In TY 2010, the IRS established a process to track and cross-reference employer-agent relationships for aggregate filers by creating Schedule R (Form 941), *Allocation Schedule for Aggregate Form 941 Filers*.[25] The Schedule R (Form 941) includes a list of all employers using the aggregate filer and the specific payroll liability, deposits, and payments for each employer reported by the agent on the aggregate Form 941.[26] Since 2007, the IRS has used transaction codes to cross-reference employers' EINs with the aggregate filer's EIN.[27]

However, the IRS is unable to link employer accounts to the EINs of PSPs because, unlike aggregate filers, PSPs file returns under the client employers' EINs. Without tracking a PSP-client relationship, the IRS cannot accurately detect PSP failures affecting multiple employers and timely intervene to assist victims and protect tax revenues.

The adoption of the Preparer Tax Identification Number (PTIN) regulations provides the IRS with an opportunity to cross-reference PTINs of paid preparers of employment tax returns, including PSPs, with EINs of their clients.[28] Systemically linking the PTIN of a PSP with EINs of its clients will enable the IRS to:

- Track the number of employers associated with a PSP;

25 Aggregate filers are also commonly referred to as "IRC § 3504 agents" or "Form 2678 agents." These agents report, deposit, and pay employment taxes of their clients under the agent's EIN. Both the section 3504 agent and the employer are liable for the employer's employment taxes while the agent authorization is in effect. See IRC § 3504; Rev. Proc. 70–6, 1970-1 C.B. 420; Form 2678, *Employer/Payer Appointment of Agent*. *See also* Prop. Reg. § 31.3504-1(b), 75 Fed. Reg. 1735-01 (Jan. 13, 2010) (allowing aggregate filing of Forms 940 if the employer is a home care service recipient (HCSR); developed in collaboration with TAS); National Taxpayer Advocate 2007 Annual Report to Congress 355-373 (Most Serious Problem: *Employment Tax Treatment of Home Care Service Recipients*).

26 IRM 5.1.24.4.4.1 (Aug. 15, 2012); 21.7.2.4.7.7 (Oct. 1, 2011). Similarly, the Schedule R (Form 940), designed for aggregate filers of the Form 940, includes a list of HCSRs as well as a breakdown of the payroll liability of each HCSR. IRM 21.7.3.4.7 (Jan. 24, 2011).

27 When an IRC § 3504 agent is appointed, a Transaction Code (TC) 971, Action Codes 382, 383, 384, or 385, is input to the employer's master file account to signify the appointment of a section 3504 agent. The TC 971 is displayed on the Integrated Data Retrieval System (IDRS) (Command Codes ENMOD and BMFOL"E") and can be cross-referenced to the aggregate agent's EIN. IRM 5.1.24.4.4(8) (Aug. 15, 2012).

28 In September 2010, Treasury issued regulations requiring paid preparers of most tax forms to obtain a PTIN. Treas. Reg. § 1.6109-2. See also Treas. Reg. § 31.6109–2; Notice 2011-6, 2011-3 I.R.B. 315.

- Identify a PSP for a Revenue Officer review or investigation when a number of delinquent employment tax returns of the PSP's clients exceeds an established threshold;
- Generate "dual confirmation" notices to all employers associated with a PSP when the number of employers' addresses changed to that of the PSP exceed a certain threshold;[29] and
- Generate notices to warn all employers associated with a failed PSP about potential accumulation of unpaid employment tax liabilities on their accounts, thereby minimizing interest and penalties and improving their ability to remain in business.[30]

Tracking Employer-PSP Relationships Would Allow the IRS to Take Timely Enforcement Actions Against Failed PSPs.

The IRS should establish an early intervention program for tracking PSP-associated delinquencies and promptly stopping failed PSPs from accumulating large balances of unpaid employment tax liabilities on their clients' tax accounts.[31] Such actions may include:

- Reprogramming the Federal Tax Deposit (FTD) Alert program to generate a field case when the accumulated balance of all delinquent employer accounts associated with a PSP PTIN exceeds a certain threshold;[32]
- Promptly initiating TFRP investigations of PSPs and responsible persons within a PSP;[33]
- Reporting a failed PSP to the proper IRS oversight office, including the IRS Return Preparer Office, IRS Office of Professional Responsibility, or the Criminal Investigation Division; and
- Referring a delinquent PSP that continues to accumulate employment tax liabilities on client employer accounts to the U.S. Department of Justice for a court injunction to curtail the increasing delinquencies.[34]

29 See IRS Office of Chief Counsel Memorandum, Ref. No. PRESP-116879-09, Use of Dual Confirmation Letters for Address Changes of Form 941 Filers Who Use Reporting Agents or Other Third Parties (Aug. 19, 2009). The dual confirmation notice is to be sent to the taxpayer's new and old address. The notice would suggest contacting the IRS only if the taxpayer has not initiated the change of address.

30 A failed PSP is a provider that does not properly report or timely pay employment taxes on behalf of its client employers for any reason, including bankruptcy or embezzlement.

31 It may take many months for the IRS to act even in routine employment tax delinquencies that are not complicated by fraud. National Taxpayer Advocate 2007 Annual Report to Congress 337-354 (Most Serious Problem: *Third Party Payers*).

32 *See* generally IRM 5.7.1 (May 15, 2012); IRM 5.1.10 (Oct. 28, 2011); IRS Notice 931, *Deposit Requirements for Employment Taxes* (Oct. 2012). The IRS historically restricted the use of the FTD Alert program to larger employers (i.e., those that have reported more than $50,000 in payroll taxes during the preceding four-quarter look-back period, which runs from July 1 through June 30 of the preceding calendar year).

33 *See* IRM 5.7.3.3.3 (July 19, 2012). Consistent with a 2004 legislative recommendation by the National Taxpayer Advocate, the IRS has issued internal guidance stating that it can assess the TFRP against third-party payers. *See* SB/SE, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer,* SBSE-05-0711-044 (July 1, 2011); National Taxpayer Advocate 2004 Annual Report to Congress 394-399.

34 *See, e.g.*, Circular 230, *Regulations Governing Practice before the Internal Revenue Service*; IRC § 7402(a).

Preventing Employers From Falling Victim to PSP Failures Could Improve Employment Tax Compliance and Alleviate Burden.

In prior Annual Reports to Congress, the National Taxpayer Advocate recommended measures that could prevent or minimize the negative impact of PSP failures on employers.[35] The National Taxpayer Advocate commends the IRS for revising guidance for Reporting Agents (Form 8655 Agents) that make Federal Tax Deposits and Federal Tax Payments (FTPs) to the IRS on behalf of clients.[36] The new guidance requires agents to use the Treasury Department's Electronic Federal Tax Payment System (EFTPS) or another electronic system (known as the Federal Tax Application (FTA)).[37] Reporting Agents also must remind their clients that the ultimate responsibility for paying taxes remains with the client and that the client should use the EFTPS system to periodically confirm that deposits have been made as expected.[38]

The IRS should expand to PSPs the requirement to remit tax deposits and payments to the Treasury electronically. Such a requirement will prevent unscrupulous PSPs from accumulating taxpayer funds intended for payment of payroll taxes by removing the opportunity for misappropriation, when the funds are transferred directly from the client's bank account to the Treasury via EFTPS or FTA. The requirement to remit employment taxes via EFTPS would also permit PSP clients to verify the payment of employment taxes in real time.

As noted in a prior report, TAS recommends that the IRS develop a competency exam for preparers of employment tax returns that are not in an exempt category (*i.e.*, attorney, certified public accountant, or enrolled agent) with a vigorous ethics component.[39] A commitment by the IRS to develop additional examinations covering payroll tax topics would send a signal to preparers and PSPs alike that the IRS is focused on noncompliance in this area.

We commend the IRS for studying the EFTPS program in connection with third-party payers.[40] The study recommended specific changes that would allow EFTPS to automatically issue "inquiry" passwords (PINs) and to email confirmations of scheduled payments

35 National Taxpayer Advocate 2009 Annual Report to Congress 261-262; National Taxpayer Advocate 2007 Annual Report to Congress 337-354 (Most Serious Problem: *Third Party Payers*).

36 The National Taxpayer Advocate and payroll industry associations long advocated for and supported these changes. *See, e.g.*, National Payroll Reporting Consortium and Independent Payroll Providers Association letter to the National Taxpayer Advocate (Feb. 5, 2008).

37 *See* Rev. Proc. 2012-32, 2012-34 I.R.B. 267, *modifying and superseding* Rev. Proc. 2007-38, 2007-1 C.B. 1442, and Rev. Proc. 2012-33, 2012-34 I.R.B. 272, *modifying and superseding* Rev. Proc. 98-32, 1998-1 C.B. 935. The guidance is effective Nov. 19, 2012. A transfer of funds to the Treasury via EFTPS can occur from a taxpayer's bank account or from a master account maintained by the third-party provider. EFTPS Batch Provider Software User Manual 20 (June 2011).

38 This disclosure statement has long been a best practice among National Payroll Reporting Consortium members. See NPRC, Government Corner, *available at* http://www.nprc-inc.org/govc.html (last visited Sept. 9, 2012).

39 National Taxpayer Advocate 2011 Annual Report to Congress 429-431.

40 SB/SE Research Study: *EFTPS Program, Requirements Change Notice for EFTPS – Final Report*, Executive Summary and Recommendations (Apr. 24, 2012).

to employers enrolled in the EFTPS by a third-party provider (payer).[41] These changes, if implemented by the Financial Management Service, will provide employers with efficient tools to monitor the actions of their PSPs or other third-party payers, verify that their employment tax obligations are timely met, and take timely actions against unscrupulous PSPs.[42]

The National Taxpayer Advocate reiterates that the IRS should promptly issue dual address change notices to alert employers when a PSP has initiated a change of address.[43] Although SB/SE and TAS created a team in 2009 to address this recommendation, the IRS has been slow to implement this change, citing cost concerns.[44] We encourage the IRS to modify the program to generate dual change of address notices, by email or text messages, after obtaining permission from taxpayers.[45] To avoid potential disclosure violations, the IRS could create a special field on employment tax returns to request express permission from taxpayers to notify them via email and text.[46] This approach would save funds and improve the efficiency and speed of notification.

Ambiguous Procedures and Inadequate Training Materials Limit the Use of ETA OICs as a Viable Collection Alternative in Providing Relief to Victims of PSP Failures.

When a PSP goes out of business or embezzles client employer funds, the employer remains ultimately responsible for unpaid tax, interest, and penalties.[47] From a taxpayer's perspective, he or she must pay the tax twice.[48]

Congress granted the IRS the authority to compromise a tax debt on the basis of hardship, public policy, and equity, by using an ETA OIC.[49] While a single PSP failure can result in millions in unpaid employment taxes and thousands of victimized employers, the IRS has underutilized the ETA offer authority.[50] As Figure 1.23.1 below shows, the number of accepted NEH-ETA OICs ranged between 21 and 45 during the past five years, with only 28

41 EFTPS Requirements Change Notice (May 1, 2012). *See also* Email Confirmation of EFTPS Payments for Clients of Third-Party Payers, Executive Briefing (Apr. 24, 2012).

42 EFTPS is managed by Treasury's Financial Management Service (FMS) bureau. *See* http://www.fms.treas.gov.

43 The notice is to be sent to the taxpayer's new and old address. The notice would suggest contacting the IRS only if the taxpayer has not initiated the change of address. This recommendation is consistent with best practices in U.S. banking industry.

44 The team currently evaluates options, preferring the one that contemplates that the address cannot be changed by filling a quarterly employment tax return. The taxpayer would have to either file the IRS Form 8822, *Change of Address* (or similar correspondence), or an annual income tax return (such as IRS Forms 1040, 1065, or 1120 series) showing a new address. In these cases, the IRS will follow up with dual confirmation notices.

45 *E.g.*, using both encrypted and unencrypted emails and text messages is a standard business practice in the banking industry. *See generally* IRC § 6103.

46 *See id.*

47 The IRS automatically assesses the Failure to File, Failure to Pay, and Failure to Deposit penalties against delinquent businesses under IRC §§ 6651(a)(1), (a)(2), and 6656, respectively. The IRS also may pursue the TFRP against the individuals it determines to be responsible who have willfully failed to pay the trust fund portion of the delinquent taxes, under IRC § 6672. Trust fund taxes represent the income tax, Social Security, and Medicare taxes employers withhold from their employees' wages.

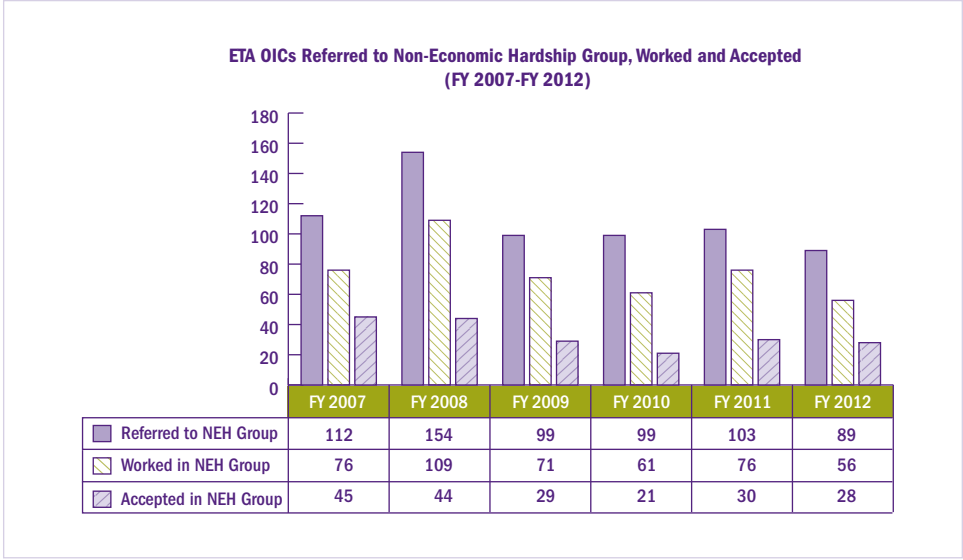
48 National Taxpayer Advocate 2007 Annual Report to Congress 344-345, 350.

49 IRC §7122(c); IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L., No. 105-206 (1998) (RRA 98). *See also* Treas. Reg. § 301.7122-1.

50 Between FY 2007 and FY 2012 (to date), as a result of the IRS's recommendations, the DOJ criminally prosecuted at least 24 owners and operators of different types of third-party payers who collected about $300 million in employment taxes from their client employers and did not pay them over to the Treasury. IRS, Employment Tax Fraud, Case Examples, FY 2007 – FY 2012,

offers accepted during the last full fiscal year (2012), a nearly 38 percent decrease from the 45 accepted in FY 2007.[51]

FIGURE 1.23.2, ETA OICs Referred to Non-Economic Hardship Group, Worked, and Accepted in FYs 2007–2012[52]



	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Referred to NEH Group	112	154	99	99	103	89
Worked in NEH Group	76	109	71	61	76	56
Accepted in NEH Group	45	44	29	21	30	28

Acting on the National Taxpayer Advocate's recommendation, the IRS conducted a study that recommended creating a separate IRM section devoted to third-party payer issues.[53] The study also recommended considering ETA OICs as viable collection alternatives for taxpayers who have been harmed by third-party payers.[54] While these recommendations were adopted in the new IRM, *Third Party Payer Arrangements for Employment Taxes*, it refers the reader to pre-existing provisions in the IRM for effective tax administration offers, which contain contradictory statements.[55] For example, IRM 5.8.11.2.2.1(4) states (in an amplifying note), "The Service will not compromise on public policy or equity grounds solely on the argument that the acts of a third party caused the unpaid tax liability (including representatives, partners, agents, or employees)." This note conflicts with the PSP example immediately preceding it, which states:

51 *See* IRS responses to TAS information requests (June 29 and Oct. 22, 2012).

52 OICs based on considerations of equity and public policy are commonly referred to as non-economic hardship ETA offers, and they are worked in a centralized offer group (NEH-ETA) located in Austin, Texas. See IRM 5.8.11.2.2 (Sept. 23, 2008). Actual decline is 37.8 percent.

53 SB/SE Study, Program Review of Third Party Payers (undated); IRS response to TAS information request (Aug. 26, 2012). *See also* IRM 5.1.24, *Third Party Payer Arrangements for Employment Taxes* (Aug. 15, 2012). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 337-354 (Most Serious Problem: *Third Party Payers*).

54 Because the IRS defines economic hardship as the inability to meet reasonable basic living expenses, it only applies to individuals (including sole proprietorships). Business entities may apply only for Non-Economic Hardship ETA OICs (*i.e.*, based on public policy or equity grounds). IRM 5.8.11.2.1 (Sept. 23, 2008); IRM 5.8.11.2.2.1 (Sept. 23, 2008). *See also* National Taxpayer Advocate 2011 Annual Report to Congress 537-543 (Legislative Recommendation: *Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers That Impose Economic Hardship*).

55 IRM 5.1.24.5.7 (Aug. 15, 2012); IRM 5.8.11.1.2.2.1 (Sept. 23, 2008).

> The taxpayer was using a payroll service provider (PSP) who deducted all tax payments from the taxpayer's bank account, yet did not remit them to the Service. The taxpayer took all reasonable precautions to prevent this from occurring. The PSP falsified documents to conceal the embezzlement. Since the abatement of interest is not available under 6404(e) on employment taxes, an offer in the amount of the tax balance may be accepted. The taxpayer's overall compliance history does not weigh against acceptance of the offer.[56]

IRS employees may be confused by these statements, and therefore use the non-economic hardship ETA OICs sporadically, harming the innocent victims of PSP misappropriation. The IRM, given the express refusal to allow an ETA OIC in a failed PSP situation, does not suggest that the IRS is willing to work with victims of embezzlement or intends to make it easier for them to enter into an OIC under the principles set forth in RRA 98.[57] The IRM example shows that current IRS's approach to PSP failures undermines and restricts the IRS's ETA OIC authority based on equity and public policy considerations.

The IRS's FY 2012 Revenue Officer training on third-party payer arrangements provides only scant mention of ETA OICs in the context of PSP embezzlement or bankruptcy, and directs readers to the associated confusing and ambiguous section of the IRM for information.[58] It does not even remotely imply that the IRS might be willing to compromise the tax and associated penalties and interest in considering an ETA offer in compromise.

The National Taxpayer Advocate remains concerned that the IRS has yet to acknowledge, in both its IRM provisions and in RO training, that, from a taxpayer's point of view, the law requires a victim of a PSP failure or embezzlement to pay the tax twice, with interest and penalties. The IRS believes it should not favor one business over another by compromising the tax liability itself, thereby giving a competitive advantage to the victim of a PSP failure over an employer that paid its taxes to the IRS. This approach ignores the fact that the victim has experienced the same economic impact of paying the amount of tax to the PSP as the competitor business that paid it to the IRS.

Victims of PSP failures are employers who tried to (and to their mind, did) comply with the tax laws. The IRS's failure to acknowledge this reality demonstrates a lack of concern for the victim's economic harm and increases the risk of future noncompliance and business failure. While commending the IRS for conducting a study on third-party payers and

56 IRM 5.8.11.2.2.1(4), Example (Sept. 23, 2008).

57 RRA 98, Pub. L. No. 105-206 (1998). The legislative history shows that Congress intended "that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements." S. Rep. 105-174, at 94, 105th Cong., 2nd Sess. (1998), Congress also expanded the IRS's OIC authority to permit considering additional factors besides the doubt as to liability or collectability. Congress anticipated "that the IRS will take into account factors such as equity, hardship, and public policy," believed "that the ability to compromise tax liability ....enhances taxpayer compliance," and expected the IRS to "be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system." H.R. Conf. Rep. 105-599, at 289, 105th Cong., 2nd Sess. (1998).

58 SB/SE CPE Training Module (FY 2012), *Third Party Payer Arrangements for Employment Taxes*; IRS response to TAS information request, Item 2 15 (July 26 2012). *See also* IRM 5.8.11.2.2.1 (4) (Sept. 23, 2008).

implementing the new IRM section, we recommend that the IRS revise the ETA OIC IRM provisions to make them consistent with the new IRM section on third-party payers and also explicitly acknowledge that the amount of tax itself may be compromised in appropriate situations. The IRS needs to educate both its own revenue officers and taxpayers about the availability of the non-economic hardship ETA OICs in PSP misappropriation situations.

Targeted Communications and a Focused Outreach Strategy Can Provide Necessary Information to Employers About the Risks Inherent in Outsourcing Payroll and How to Protect Themselves.

We agree with the IRS that employers should use due diligence in choosing a PSP.[59] However, as a tax administration agency, the IRS has an obligation to educate taxpayers about their tax responsibilities and facilitate prudent compliance. In recent years, the IRS has substantially improved the information about PSPs and other TPPs on its website.[60] However, it needs a more comprehensive, targeted communications and outreach strategy to inform small businesses and self-employed individuals about the different third party arrangements for payment of employment taxes and how to protect against risks inherent in outsourcing payroll tax obligations. Such a strategy should include seminars and presentations in local communities to address compliance and cultural issues in those communities.[61]

We recommend that IRS use innovative and cost effective ways of educating employers about TPPs, including email and text messages, webcasts, online chats, and smartphone applications. The IRS also should modify its employment tax forms and publications to discuss the risks associated with outsourcing payroll, and use correspondence, including notices and "soft letters" as an opportunity to educate taxpayers about EFTPS.[62]

CONCLUSION

The National Taxpayer Advocate is pleased that the IRS has made significant progress in addressing problems with PSPs and other third party payers identified in prior Annual Reports to Congress. We also commend the IRS for the fruitful collaboration with TAS on these issues.

59 National Taxpayer Advocate 2007 Annual Report to Congress 344.

60 *See* Third Party Payer Arrangements, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Outsourcing-Payroll-and-Third-Party-Payers. (last visited Sept. 11, 2012). *See also* Employment Tax Fraud, Case Examples, FY 2010 – FY 2012, http://www.irs.gov/uac/Examples-of-Employment-Tax-Fraud-Investigations---Fiscal-Year-2012 (last visited Sept. 11, 2012).

61 In FY 2011, SB/SE targeted less than a quarter of outreach events directly to small business owners and lacked outreach and education employees in 12 states. *See* Most Serious Problem: *The IRS Is Substantially Reducing Both the Amount and Scope of its Direct Education and Outreach to Taxpayer and Does not Measure the Effectiveness of its Remaining Outreach Activities, Thereby Risking Increased Noncompliance, infra/supra.*

62 The National Taxpayer Advocate applauds the IRS for its recent efforts to reassess the benefits of using "Soft Letters" with a broader range of taxpayers. IRS response to TAS information request (July 26, 2012), Item 5: FTD Soft Letter Project (July 2011).

However, the National Taxpayer Advocate is concerned that the IRS is slow in implementing necessary measures and investing necessary resources in early detection and timely intervention in PSP delinquencies. As a result, absent effective collection alternatives, many victims of PSP misappropriation may face grave financial harm and be forced to close doors and lay off employees. The IRS can and should do more to alleviate harm to taxpayers affected by PSP failures.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Develop programming that can systemically link the PTIN of a PSP with EINs of its clients and track the number of employers associated with the PSP.
2. Develop programming that can systemically select a PSP for a Revenue Officer examination when the number of delinquent employment tax returns of clients of a PSP exceeds an established threshold.
3. Establish an early intervention program for tracking PSP-associated delinquencies and taking prompt actions to stop failed PSPs from continuing to accumulate large balances of unpaid employment taxes on their clients' tax accounts.
4. Require PSPs (who are not Reporting Agents) to remit federal tax deposits and payments to the Treasury via EFTPS or FTA.
5. Consistent with the SB/SE study recommendations, request the FMS to program EPTPS to automatically issue "inquiry" passwords (PINs) and to email confirmations of scheduled payments to employers enrolled in the EFTPS by a third-party provider (payer).
6. Develop a competency exam for preparers of employment tax returns with a vigorous ethics component.
7. Begin using dual address change letters alerting employers that a PSP has initiated a change of address, including notifications via email or text messages to taxpayers who so consent in a special field on employment tax returns.
8. Promote the use of ETA OICs as a viable collection alternative for victims of failed PSPs by revising the IRM to specifically state that the amount of tax may be compromised in appropriate instances and by developing adequate training materials for employees.
9. As part of a comprehensive outreach strategy, alert employers about the risks inherent to outsourcing payroll in employment tax forms and publications, IRS Notices, and other correspondence.

IRS COMMENTS

The IRS acknowledges that some small businesses can be adversely impacted when the third party they hired to handle its employment tax responsibilities fails to fulfill its obligations. While the IRS does play an important role in assisting employers that fall victim to fraudulent PSPs, under the law, the employer is not relieved from its employment tax obligations when entrusting intermediaries with the deposit and payment of their federal tax liabilities. The IRS strongly and consistently encourages employers using third-party payroll providers to use due diligence in the selection of a third-party payer with regard to the compliance associated with their tax obligations.

To that end, the IRS is working hard to educate employers on the risks associated with outsourcing payroll and how to protect themselves. We maintain a webpage, "Outsourcing Payroll Duties," on IRS.gov.[63] This webpage encourages employers using third-party payroll providers to verify and confirm timely deposits made on their behalf by utilizing the EFTPS. The webpage also guides employers on how to respond if they believe that a bill or notice received is a result of a problem with their payroll service provider. In addition, the IRS routinely focuses outreach efforts on employers who outsource their payroll with a variety of communications, including a special edition of Tax Tips, articles in e-News for Small Businesses and the SSA/IRS Reporter, a video on IRS.gov, and an outreach initiative.[64]

While educating employers on understanding the need for due diligence in selecting a third-party payer and exercising appropriate oversight of PSP deposit practices is essential, the IRS also acknowledges the benefits of early intervention and its importance in the prevention of pyramiding employment tax liabilities. Specifically, the IRS utilizes the FTD Alert process, which helps to identify, at an early stage, a depositor who has not made federal tax deposits during the current quarter, or who has made deposits in substantially lower amounts from prior quarters. When appropriate, the FTD Alert program generates an alert in the name of a PSP client taxpayer and triggers a Revenue Officer to contact the business within ten days. Typically, this contact occurs prior to the due date of the current employment tax return and can be successful in detecting when the PSP is not making timely deposits. Additionally, the IRS is also engaged in a collaborative effort with Financial Management Service and the payroll industry to develop enhancements to EFTPS which will provide additional opportunities for employers to verify and confirm timely deposits made by a third party.

63 *See* Outsourcing Payroll Duties available at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Outsourcing-Payroll-Duties (last visited on Nov. 8, 2012).

64 *See, e.g.,* Special Edition Tax Tip 2011-05, Sept. 2, 2011 *available at* http://www.irs.gov/uac/Three-Tips-for-Employers-Outsourcing-Their-Payroll; Outsourcing Payroll Duties article in e-News for Small Businesses (Issue 2011-17, Aug. 3, 2011); IRS video Outsourcing Payroll available at http://www.irsvideos.gov/SmallBusinessTaxpayer/Employers/OutsourcingPayroll2011; and SB/SE Outreach Initiative available at http://sbse.web.irs.gov/CL2/SL/outreach_initiatives/rq_view.asp?id=274.

The IRS appreciates the National Taxpayer Advocate's acknowledgement of the significant progress we have made to address PSP and other third-party payer failures. During FY 2012, we created and published IRM section 5.1.24, *Third-Party Payer Arrangements for Employment Taxes*. This new IRM section provides comprehensive guidance for Collection employees on the various types of third-party payer arrangements for employment taxes that exist, explains how these third-party payer arrangements may affect collection and helps to ensure fair and consistent treatment. Guidance for the assessment of the Trust Fund Recovery Penalty also was updated to include consideration of potentially responsible parties within a PSP or a professional employer organization. The new guidance and procedures were effectively reinforced through comprehensive training to all field contact employees during 2012.

In further demonstration of our efforts to ensure consistent and fair treatment of taxpayers adversely impacted by deceptive third-party payers, a new Letter 4838, *Payroll Service Provider Client*, was made available to Collection employees for use in contacting clients of a non-compliant PSP. This letter encourages those PSP clients to contact the IRS to resolve any outstanding liabilities and addresses the potential for penalty abatement. Additionally, the Reasonable Cause Assistant (RCA) program has been modified to include additional questions to better identify employers adversely affected by their third-party payer and grant the employers penalty relief. Additional questions have also been added to Form 4180, *Report of Interview with Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Taxes*, to aid revenue officers in TFRP investigations where a PSP or a PEO is involved. The additional information helps to ensure field employees have sufficient facts and information to make informed decisions on how best to resolve these cases.

And finally, the IRS agrees that the Effective Tax Administration offer in compromise is a viable collection alternative for those taxpayers that meet the established ETA criteria. To that end, upon initial contact with an employer whose liability was affected by the actions of a third-party payer, revenue officers are instructed to discuss an ETA OIC as part of the collection determination.[65]

The National Taxpayer Advocate makes nine preliminary recommendations to help victims of failed payroll service providers and increase employment tax compliance. The IRS is taking or has taken the following actions with respect to these recommendations:

The IRS agrees that tracking the number of employers associated with a PSP has value. While linking the PTIN of a PSP with the EINs of its clients is one option to use for tracking a PSP — client relationship, it may not be feasible due to the extensive programming costs and the relatively small number of impacted accounts. As such, we will continue to analyze various options for establishing a systemic linkage between a PSP and its clients that does not create additional taxpayer burden through additional reporting requirements.

65 *See* IRM 5.1.24.5.2(2)(e) (Aug. 15, 2012).

Until the successful implementation of a systemic linkage between a PSP and its clients, as discussed above, programming cannot be created to systemically select a PSP for revenue officer (RO) examination when the number of delinquent client employment tax returns exceeds a set threshold.

We agree with the benefits of an early intervention program to identify PSP-associated delinquencies and efforts to take prompt actions on these accounts. Accordingly, as part of a pilot operation, the IRS is actively testing and studying the use of Letter 4594, FTD Soft Letter, to improve the FTD Alert early intervention program and increase the ability for PSP client identification. This "soft letter notice" is used to contact business taxpayers in which account indicators are present that a potential tax liability will exist for the business due to reduced FTDs. The soft letter notice explains the importance of making federal tax deposits timely and the consequences if not made timely. The letter also reminds the taxpayer to file the Form 941 timely to prevent additional penalties and provides IRS contact information if assistance is needed. While the results of the pilot are being evaluated, preliminary information indicates this effort has been effective in reacting faster and earlier to indicators that a business may be in trouble and by providing education to taxpayers before a significant liability occurs. Metrics have been developed to assist the IRS in determining the overall impact the soft letter notice will have on future compliance. We believe this overall approach will assist in making data driven decisions to improve the FTD Alert early intervention program and increase the ability for PSP clients to be identified.

To provide further early intervention opportunities for clients of PSPs, the IRS has proposed implementation of additional tools within the EFTPS, which will allow the taxpayer to timely monitor federal tax payments being made on their behalf.

The IRS agrees with requiring PSPs (who are not Reporting Agents) to remit federal tax deposits via EFTPS. Consistent with this recommendation, the U.S. Department of Treasury executed Treasury Decision (T.D.) 9507.[66] T.D. 9507 provides rules under which all depositors, including PSPs, must use electronic funds transfer (EFT) for all FTDs and eliminates the rules regarding FTD coupons. These regulations became effective January 1, 2011.

In May 2012, FMS approved our request for the automatic issuance of inquiry PINs for clients of PSPs and other third-party providers (payers) and email confirmations of scheduled payments from EFTPS.[67] We are actively working with FMS and the payroll industry on methods to implement these enhancements to the system.

As acknowledged by the National Taxpayer Advocate in the 2011 Annual Report to Congress,[68] establishing a testing program is an extensive undertaking. Due to the size and vulnerability of the individual taxpayer population, the IRS focused initially on one return

66 *See* T.D. 9507, 2011-3 I.R.B. 305.

67 *See* Requirements Change Notice 293 for Inquiry PINs and Email (May 11, 2012).

68 National Taxpayer Advocate 2011 Annual Report to Congress 427-430.

preparer examination, starting with the Form 1040 series returns. Prior to proceeding with the development of any additional examinations, the IRS needs to assess the impact of the Registered Tax Return Preparer test and review the costs and benefits of the test. Over the next several years, we will be reviewing various metrics that measure the success of the program.

The IRS is continuing its efforts to complete implementation actions associated with a prior National Taxpayer Advocate Annual Report to Congress recommendation regarding issuance of dual address change letters.[69] Consistent with this effort, the IRS has researched the feasibility of implementing change of address notices to all business taxpayers that use a PSP. Following a thorough analysis of several options, specific recommendations for the implementation of a dual address change process are now being considered by IRS Counsel. The recommendations now being considered include:

- Establishment of an official mailing address for the company. This address will be the address on the income tax return.
- No change of address will be made unless the taxpayer files Form 8822-B, *Change of Address – Business*, or other correspondence from the taxpayer, which will then be followed up with a confirmation letter to the taxpayer at the old and new addresses.

The IRS will continue to pursue the successful and cost effective implementation of this recommendation. The IRS would need additional time to consider notification of address changes via email or text message as security and disclosure concerns must be considered.

To promote the use of ETA OICs as a viable collection alternative for victims of failed PSPs, the IRS has revised the IRM to specifically state that the amount of tax may be compromised in appropriate instances. We also developed training materials for employees. Other planned actions include:

- Conducting training in the recognition of ETA economic hardship and non-economic hardship situations with all offer examiners and offer specialists who investigate OICs during the first quarter of FY 2013.
- Developing an ETA and Non-economic Hardship (NEH) ETA training course for field revenue officers for inclusion in CPE for FY 2013.
- Completing a revision to IRM 5.8.11, *Effective Tax Administration*, during FY 2013, which will include additional examples of situations where acceptance of an offer under public policy or equity may be appropriate, and note that the amount of tax may be compromised when appropriate.

The IRS agrees that it is important to educate employers on the risks associated with outsourcing payroll duties via employment tax forms and publications, IRS notices, and other correspondence. We recently proposed adding language to the instructions for the

69 National Taxpayer Advocate 2010 Annual Report to Congress 179.

94X series of employment tax returns and to the Publication 15, *(Circular E), Employer's Tax Guide*, to caution employers about changing their mailing address to that of their PSP and provide alternative methods for payroll providers to receive copies of IRS notices. Employers will also be alerted to their responsibility for employment taxes in the new EFTPS inquiry PIN letters and email confirmations of scheduled payments. The IRS will continue to examine its products and services for additional opportunities to provide employers with information on outsourcing payroll.

In conclusion, the IRS is committed to improving its policies and procedures with PSPs and other third-party payers who are entrusted by employers to file and pay on their behalf. While the ultimate responsibility remains with the employer to use due diligence in handling employment tax obligations, the IRS will continue its efforts to focus on educating taxpayers, developing early intervention tools, and encouraging the use of the ETA OIC as a viable collection alternative in hopes of decreasing and/or minimizing the burden and financial impact to the taxpayer.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS recognizes the burdens facing small businesses that are adversely affected by PSP failures. We also commend the IRS for its significant progress in improving outreach to employers about the risks associated with outsourcing payroll and how to protect themselves. The National Taxpayer Advocate is pleased with the requirement to remit all federal deposits, including those made by PSPs on behalf of their clients, using EFTPS. We are encouraged by the FMS's approval of the automatic issuance of inquiry PINs for clients of PSPs and other third-party providers (payers) and email confirmations of scheduled payments from EFTPS. These changes will improve service to affected employers and minimize the risks associated with using a PSP. We hope that the IRS will promptly implement these enhancements to the system and use modern technology (*e.g.*, email alerts and text messages) to educate employers about risks associated with outsourcing payroll.

However, the IRS can and should do more to alleviate the harm to victims of PSP failures. The IRS cannot limit its role to education and outreach, relying on the employer's ultimate responsibility for payment of employment taxes. Instead, the IRS should take an active role in the prevention of PSP delinquencies and the resolution of PSP-related liabilities. As stated above, each PSP failure can affect thousands of employers and millions of dollars in unpaid payroll taxes. Because the victims of defunct PSPs will have to pay the amount of tax twice — once to the PSP, and again to the IRS — some will go out of business, leaving their employees without jobs and often leaving the IRS with scarce assets from which to collect.

The National Taxpayer Advocate remains concerned about the IRS's unwillingness to commit resources to the tracking of the employer-PSP relationship and early intervention in PSP cases. As the IRS acknowledges, without a systemic linkage between a PSP and its clients, it cannot design an effective early intervention program to identify PSP-associated delinquencies and take prompt actions on these accounts. The National Taxpayer Advocate is disappointed with the IRS's assumption that implementation of such a linkage "may not be feasible due to the extensive programming costs and the relatively small number of impacted accounts." The IRS should estimate the programming costs for cross-referencing employers' accounts with the PSP account using PTINs and pilot the systemic linkage to estimate the number of affected employers. It can then estimate the amount of revenue at risk if the identified PSPs go out of business and a Revenue Officer does not take prompt action. The National Taxpayer Advocate believes that the IRS should use a data-driven approach in determining feasibility of systemic linkage between PSPs and their client accounts.

While appreciative of the IRS's efforts to improve the FTD Alert early intervention program and increase the ability for PSP client identification using Letter 4594, FTD Soft Letter, the National Taxpayer Advocate believes that an effective early intervention program will not occur without the systemic linkage described above, especially in cases where a delinquent PSP changes addresses of client employers. It has been almost five years since the National Taxpayer Advocate recommended the use of dual confirmation letters when a PSP changes a client employer's address without a proper authorization.[70] Even though the IRS and TAS have collaborated on a number of options, none have been implemented so far. The National Taxpayer Advocate believes the IRS should establish timeframes for implementation of these address change notifications, including email and text message options.

The National Taxpayer Advocate believes that the importance of maintaining high standards of competence and due diligence among preparers of employment tax returns outweighs any cost-related concerns. A competency examination for PSPs and other employment tax return preparers will undoubtedly improve compliance and reemphasize the IRS's focus on noncompliance in this area. The IRS should establish timeframes for developing a competency examination and its implementation.

Finally, the National Taxpayer Advocate appreciates the IRS's acknowledgement of ETA OICs as a viable collection alternative for victims of defunct PSPs and the IRS's commitment to revise the relevant IRM and develop training materials for Revenue Officers. The IRS should publicize that the amount of tax itself may be compromised in appropriate situations. The National Taxpayer Advocate believes TAS should be afforded an opportunity to review this upcoming IRM revision and training materials.

70 National Taxpayer Advocate 2007 Annual Report to Congress 337-354.

Recommendations

In conclusion, the National Taxpayer Advocate recommends that the IRS:

1. Develop the business case for programming that can systemically link the PTIN of a PSP with EINs of its clients, track the number of employers associated with the PSP, and implement a pilot program to estimate the number of affected employers and impact to the public fisc.
2. Develop programming that can systemically select a PSP for a Revenue Officer examination when the number of delinquent employment tax returns of clients of a PSP exceeds an established threshold.
3. Develop a competency exam for preparers of employment tax returns with a vigorous ethics component.
4. Establish ascertainable timeframes for beginning the use of dual address change letters alerting employers that a PSP has initiated a change of address, including email or text message notifications to taxpayers who so consent in a special field on employment tax returns.
5. In consultation with TAS, revise the IRM and training materials to promote the use of ETA OICs as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances.
6. As a part of a comprehensive outreach strategy, use modern technology, such as text messaging and email alerts to educate employers about the risks inherent to outsourcing payroll.

Status Update: Underfunding of IRS Initiatives to Modernize Its Taxpayer Address Systems Undermines Taxpayers' Statutory Rights and Impedes Efficient Resource Allocation

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DEFINITION OF PROBLEM

Over 19 million pieces of mail each year, or about ten percent of all correspondence the IRS sends to taxpayers, are returned as "undeliverable as addressed."[1] Yet important statutory rights have time limits that begin to run when the IRS *sends* the taxpayer a notice or letter, regardless of whether the taxpayer actually *receives* it. The problem is even more pronounced for international taxpayers because IRS addresses do not conform to the receiving country's address standards in nearly two of every three international mailings.[2]

Since the National Taxpayer Advocate raised the issue in 2010, the volume of undelivered mail has increased.[3] The IRS has begun to address the problem by assigning this issue to the Office of Taxpayer Correspondence (OTC) and funding an initiative to uniquely identify each piece of outgoing mail with a full-service intelligent mail bar code (FSIMB). However, it has yet to:

- Fully fund remaining phases of the FSIMB program;
- Adjust its databases to properly accommodate international addresses; and
- Create an enterprise-level organization to oversee the modernization of mail systems.

By implementing these changes, the IRS will significantly reduce the volume of undelivered mail and its negative impact on taxpayers.

1 National Taxpayer Advocate 2010 Annual Report to Congress 221 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*), *available at*: http://www.taxpayeradvocate.irs.gov/files/VOL%201_MSP%2016_21_TaxAdministration.pdf.

2 IRS, Wage and Investment Division (W&I), CARE/M&P: Mail Management Project Office, *International Mail Impact Analysis Final Report* (July 2007), reporting that 65 percent of international mail is undeliverable.

3 IRS response to TAS information request (Oct. 15, 2012).

ANALYSIS OF PROBLEM

Background

The IRS still relies upon its many notices and letters — collectively referred to as "correspondence" — as its primary means of communication with taxpayers. The IRS mails over 200 million pieces of correspondence to taxpayers each year, including paper refund checks, with an "undeliverable" rate of approximately ten percent.[4] Sixty-five percent of all international mail is classified as undeliverable as addressed. The international address the IRS uses is not correctly formatted to meet the receiving country's address standards.[5]

Nevertheless, taxpayers have important statutory rights that must be claimed within strict periods that often begin to run when the IRS *sends* a notice. For example:

- Internal Revenue Code (IRC) § 6213(a) provides that a taxpayer has 90 days after the IRS sends a statutory notice of deficiency (150 days if addressed to a taxpayer outside the United States) to petition the Tax Court.
- IRC § 6213(b) provides that taxpayers have 60 days after the IRS notifies them of a math error assessment to request abatement of the additional assessment and avail themselves of deficiency procedures.
- IRC § 6320 provides that a taxpayer has 30 days after the IRS sends him or her a notice of lien filing to request an administrative hearing, the outcome of which may be appealed to the Tax Court.[6]
- IRC § 6330 provides that a taxpayer has 30 days after the IRS sends him or her a final notice of its intent to levy to request an administrative hearing, the outcome of which may be appealed to the Tax Court.

Delays created by undelivered mail may also mean that taxpayers do not receive refunds or pay tax liabilities timely, leaving them liable for interest and penalties that could have been avoided.

Undelivered mail is also expensive for the IRS. The Treasury Inspector General for Tax Administration (TIGTA) estimates that wasted printing and postage alone cost the IRS $57.9 million in fiscal year (FY) 2009.[7] Other costs include manual processing of undelivered mail, account rework, and avoidable collection and enforcement actions.

4 National Taxpayer Advocate 2010 Annual Report to Congress 221 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*), *available at*: http://www.taxpayeradvocate.irs.gov/files/VOL%201_MSP%2016_21_TaxAdministration.pdf.

5 IRS, W&I, CARE/M&P: Mail Management Project Office, *International Mail Impact Analysis Final Report* (July 2007).

6 IRC §§ 6320(c), 6330(d).

7 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-40-055, *Current Practices Are Preventing a Reduction in the Volume of Undelivered Mail* (May 14, 2010), *available at* http://www.treasury.gov/tigta/auditreports/2010reports/201040055fr.html.

The IRS is Taking Steps to Address Undelivered Mail Problems.

Since the National Taxpayer Advocate's 2010 Annual Report to Congress, the IRS has assigned the Office of Taxpayer Correspondence (OTC) to identify, organize, and coordinate efforts to modernize mail systems and significantly reduce undelivered mail. The OTC established a working group, including a TAS representative, that identified and recommended funding for various changes. These changes include restructuring databases that handle international addresses and releasing funds to implement FSIMB in several phases. The IRS has agreed to fund the first phase of FSIMB, which consists of affixing a bar code to all notices and letters to taxpayers, in FY 2013.[8] Because the USPS gives barcode users a discount of $.003 per piece of mail, the one-time cost of about $1 million for this phase is expected to yield annual savings of $600,000 in postage costs alone.[9]

Additional Phases of FSIMB Need Funding To Obtain the Benefits of Bar Coding.

USPS systems read the information on FSIMB bar codes and can transmit information about a bar-coded piece of mail back to the IRS. For example, in addition to identifying a piece of mail as undeliverable, USPS will be able to tell the IRS when there is no such number or no such street as shown on the address, when the premises on the address are vacant, or when the addressee is deceased.[10] Once the IRS adjusts its systems to enable them to receive this information from USPS, the IRS will be able to quickly detect addressing errors or find a new or "better" address.[11] The IRS will also be able to use information in a bar code to quickly route returned correspondence to the proper IRS organization. The information may also help identify or confirm cases of identity theft. Later phases of the FSIMB initiative will provide these capabilities, but to date the IRS has not allocated funds for their implementation.[12]

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8 IRS Agency-Wide Shared Services Web Request Tracking System TIRNO-08-Z-00014 DO 0105 award Sept. 21, 2012. The bar code will be affixed to mail that emanates from one of two IRS National Print Sites (NPS). In fiscal year 2009, 201,254,976 notices and letters were printed and mailed at the two sites, and an additional 45 million tax forms, publications, and other information items were mailed by IRS Media and Publications. National Taxpayer Advocate 2010 Annual Report to Congress 221 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*), *available at*: http://www.taxpayeradvocate.irs.gov/files/VOL%201_MSP%2016_21_TaxAdministration.pdf.

9 TIGTA, Ref. No. 2010-40-055, *Current Practices Are Preventing a Reduction in the Volume of Undelivered Mail* (May 14, 2010), *available at* http://www.treasury.gov/tigta/auditreports/2010reports/201040055fr.html (calculating the $600,000 by multiplying the number of notices the IRS mails annually by the discount the USPS gives for using the bar code (200,000,000 x $.003); IRS requisition Q2-QF-01-WG-C07-000 shows the cost of the first phase of the initiative as $1,032,187.53.

10 USPS will transmit this information by means of codes, referred to as NIXIE Codes, that signify various things. For example, code A means "Attempted – Not Known;" code B means "Returned for Better Address;" code P means "Deceased," and so forth.

11 The IRS currently attempts to obtain a "good" or "better" address for 24 notices that are returned as undeliverable. Most of these are collection-related notices such as balance due, return delinquency, intent to levy, or installment agreement default notices. National Taxpayer Advocate 2010 Annual Report to Congress 226 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*) *available at* http://www.taxpayeradvocate.irs.gov/files/VOL%201_MSP%2016_21_TaxAdministration.pdf. This year, the National Taxpayer Advocate recommends clarifying that the IRS's obligation to exercise due diligence in sending mail to a taxpayer's last known address requires that it search its databases for a "good" or "better" address for all returned mail. See Legislative Recommendation, *Amend IRC § 7701 to Provide a Definition of "Last Known Address," and Require the IRS to Mail Duplicate Notices to Credible Alternate Addresses*, *infra*.

12 IRS requisition Q2-QF-01-WG-C07-00 authorizes funding for only the first phase of the initiative.

The IRS Needs an Enterprise-Level Organization to Oversee the Modernization of its Mail Systems.

The IRS must program an array of systems to properly display both domestic and international addresses and accommodate mail tracking information.[13] Once the IRS modernizes these systems, an enterprise-level organization to maintain and update the systems will be essential. As the National Taxpayer Advocate has pointed out, undelivered mail affects the efficiency of every IRS operation.[14] Without a single organization to oversee agency-wide operations, improvements to mail handling will be fragmented among the operating divisions, and the IRS will risk losing the benefits of the improvements it has made or may make.

CONCLUSION

In conclusion, the National Taxpayer Advocate recommends that the IRS:

1. Fully fund and implement all phases of FSIMB.
2. Update IRS databases to allow them to accommodate international addresses.
3. Identify an enterprise-level organization to oversee modernization and maintenance of IRS mail systems.

13 These include database and inventory management systems that pertain to: individuals, businesses, payer and employee plans, backup withholding, tax delinquent accounts, delinquency investigations, account correspondence, transcript delivery, examination, information returns, taxpayer representatives, payroll agents, underreported income, substitutes for returns, exempt organizations, automated collection, liens, levies, taxpayer identification numbers, residency certification, tax deposits and address research.

14 National Taxpayer Advocate 2010 Annual Report to Congress 225 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*), *available at* http://www.taxpayeradvocate.irs.gov/files/VOL%201_MSP%2016_21_TaxAdministration.pdf.

Status Update: Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses

RESPONSIBLE OFFICIALS

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DEFINITION OF PROBLEM

Domestic partners and same-sex spouses face unique federal tax challenges while the legal landscape rapidly evolves. The National Taxpayer Advocate's 2010 Annual Report to Congress (2010 Report) listed five questions about taxation of domestic partners and same-sex spouses, two of which the IRS has addressed.[1] Since then, additional issues have created several more conundrums that significantly affect individuals as well as corporations with contracts covering same-sex couples. Questions stem from IRS treatment of community property, such as subjecting a proprietor's same-sex partner who does not work in the business to self-employment tax. Outdated processes have rejected electronically filed (e-filed) returns that reflected withholding in excess of that on Forms W-2, *Wage and Tax Statement,* even after the IRS confirmed that domestic partners allocate withholding credit to the partner taxed under community property.[2]

Since the 2010 Report, same-sex marriage laws have advanced in five states and two countries, while domestic partnerships have become available in three additional states.[3] Data newly derived from the 2010 Census double the number of same-sex couples previously reported.[4] Consequently, more than one million individuals in same-sex marriages and domestic partnerships need guidance on federal tax questions.

1 See National Taxpayer Advocate 2010 Annual Report to Congress 211, 215 (Most Serious Problem: *State Domestic Partnership Laws Present Unanswered Federal Tax Questions*).

2 This issue is addressed by IRS, *Work Request Notification 20120622161808* (June 22, 2012) (modifying Form 8958, *Allocation of Tax Amounts Between Married Filing Separate Spouses, Same-Sex Spouses, or Registered Domestic Partners with Community Property Rights*).

3 See Marriage Equality Act, N.Y. Assembly Bill 8354 (2011) (effective 30 days after enactment on June 24, 2011); *Perry v. Brown*, 671 F.3d 1052 (9th Cir. 2012) (finding unconstitutional, pending further appeal, 2008 Calif. Prop. 8 ban on same-sex marriage); Maine Question 1 (referendum approved Nov. 6, 2012); Md. Sen. Bill 241. 430th Sess. (2012) (approved by referendum Nov. 6, 2012); Wash. Sen. Bill 6239, 62nd Leg. (2012) (approved by referendum Nov. 6, 2012); *Denmark Approves Same-Sex Marriage and Church Weddings*, BBC News, bbc.co.uk/news/world-europe-18363157 (June 7, 2012); John Lyons, *Brazil Top Court Grants Equal Rights to Same-Sex Unions*, Wall St. J. (May 6, 2011); Del. Sen. Bill 30, 146th Gen. Assemb. (enacted May 11, 2011) codified at Del. Code Tit. 13, Ch. 2 (effective 2012); Ill. Religious Freedom Protection & Civil Union Act, Pub. Act No. 96-1513 (2011); R.I. House Bill 6103 (2011) (effective Jul. 1, 2011).

4 See Gary J. Gates & Abigail M. Cooke, *U.S. Census Snapshot*, Williams Inst., Univ. of Calif., L.A. (2010) 1, 3 (reflecting 131,729 and 514,735 same-sex marriages or other partnerships, respectively, 17 percent of which were raising their own children).

ANALYSIS OF PROBLEM

Background

The Defense of Marriage Act (DOMA) continues to prohibit federal recognition of same-sex marriages.[5] Pending Supreme Court review, the First Circuit appellate court has held that "denial of federal benefits to same-sex couples lawfully married in Massachusetts has not been adequately supported by any permissible federal interest."[6] In a case recently affirmed by the Second Circuit, the Justice Department argued, and the trial court agreed, that "DOMA unconstitutionally discriminates" by effectuating a tax that otherwise "the estate would not have paid due to the marital deduction."[7]

Assuming the current validity of DOMA, the IRS has yet to answer several questions. In response to the 2010 Report, the IRS took the position that guidance would be premature in a rapidly evolving landscape and unwarranted for an insignificant number of taxpayers. Nonetheless, the IRS has published guidance for relatively discrete populations.[8] Moreover, in a 2011 letter to a taxpayer, the IRS Office of Chief Counsel (CC) treated Illinois opposite-sex civil union partners as married filing jointly,[9] which DOMA presumably would not allow for same-sex partners. On the other hand, state and federal courts have indicated that partners are not "spouses" to whom DOMA would apply.[10] Consequently, the federal tax status of partners is now unclear.

5 *See* 1 U.S.C. § 7, Pub. L. No. 104-199, 110 Stat. 2419 (1996).

6 *Massachusetts v. U.S. Dep't of Health & Human Servs.*, 682 F.3d 1, 16 (1st Cir. 2012).

7 Defendant U.S.' Memo. of Law in Response to Plaintiff's Mot. for Summary Judgment and Intervenor's Mot. to Dismiss at 1, *Windsor v. U.S.*, 833 F.Supp.2d 394 (S.D.N.Y. Aug. 19, 2011) (No. 10 Civ. 8435); *Windsor*, 833 F.Supp.2d 394 (holding DOMA unconstitutional for IRC § 2056 purposes), *aff'd* No. 12-2335 (2nd Cir. Oct. 18, 2012); *see also Pedersen v. OPM*, No. 3:10-cv-1750 (VLB) (D.Conn. Jul. 31, 2012) (holding DOMA unconstitutional).

8 *See, e.g.*, Rev. Proc. 2010-41, 2010-48 I.R.B. 781 (including guidance for return preparers without a Social Security number due to religious objection); Rev. Proc. 2010-31, 2010-40 I.R.B. 413 (setting forth guidance on when a foreign adoption is final for parents who claim a tax credit for expenses of adopting a child); Notice 2010-30, 2010-18 I.R.B. 650 (containing guidance for military spouses who are civilians working in a U.S. territory but claiming residence in a state); Rev. Rul. 2004-71, 2004-2 C.B. 74 (applying IRC § 6402 refund offset to community property in Arizona and Wisconsin); Rev. Rul. 2004-72, 2004-2 C.B. 77 (applying refund offset to community property in California, Idaho, and Louisiana); Rev. Rul. 2004-73, 2004-2 C.B. 80 (applying refund offset to community property in Nevada, New Mexico, and Washington); Rev. Rul. 2004-74, 2004-2 C.B. 84 (applying refund offset to community property in Texas); Rev. Rul. 68-277, 1968-1 C.B. 526 (disregarding anti-miscegenation statutes as unconstitutional); Rev. Rul. 58-66, 1958-1 C.B. 60 (recognizing common-law marriage).

9 Gen. Info. Ltr. (Aug. 30, 2011) ("if Illinois treats the parties to an Illinois civil union who are of opposite sex as husband and wife, they are considered 'husband and wife' for purposes of Section 6013 of the Internal Revenue Code, and are not precluded from filing jointly").

10 *See Smelt v. Orange County*, 447 F.3d 673 (9th Cir. 2006) (denying standing to challenge DOMA by partners who "are not in a relationship that has been dubbed marriage by any state, much less by the State of California") *cert. den'd* 549 U.S. 959 (2006); *Bishop v. Okla.*, 447 F. Supp. 2d 1239, 1247 (N.D. Okla. 2006) (denying partners standing to challenge DOMA even though state statute grants a civil union "all the same benefits, protections and responsibilities under law" as marriage, because "a Vermont civil union is not the equivalent of a marriage"), *rev'd & remanded* on other issue 333 Fed. Appx. 361 (10th Cir. 2009); *Strauss v. Horton*, 46 Cal.4th 364, 445 (2009) ("the designation of 'marriage' is, by virtue of the new state constitutional provision, now reserved for opposite-sex couples"); *Knight v. Schwarzenegger*, 26 Cal.Rptr.3d 687, 690 (2005) ("domestic partners act did not constitute an amendment of the defense of marriage initiative").

The IRS Has Released Informal Guidance that Addresses Some Questions About Domestic Partner and Same-Sex Spousal Taxation.

The IRS Answered Questions TAS Posed

While professing that guidance would be premature, the IRS nevertheless posted questions & answers (Q&As) on its website, IRS.gov, addressing some questions specifically posed by the 2010 Report in the context of a discussion of same-sex couples in community property states. Curiously, these Q&As "for Registered Domestic Partners (RDPs) in Community Property States and Same-Sex Spouses in California" purported to be limited geographically, while buried on the website at an uncertain level of authority.[11] As currently updated, the Q&As are not limited to California, although they still do not constitute formal rulemaking. At this point, the Q&As have answered two questions from the 2010 Report:[12]

> *[Q] Does a parent-child relationship persist even if DOMA disregards the parent's marriage?*[13]
>
> [A] "If a same-sex partner is the stepparent of his or her partner's child under the laws of the state in which the partners reside, then the same-sex partner is the stepparent of the child for federal income tax purposes."[14]
>
> *[Q] Is a domestic partner or same-gender spouse in a community property state deemed to provide, for dependency purposes, the support that he or she earns?*[15]
>
> [A] "A registered domestic partner can be a dependent of his or her partner if the requirements of sections 151 and 152 are met. However, it is unlikely that registered domestic partners will satisfy the gross income requirement of section 152(d)(1)(B) and the support requirement of section 152(d)(1)(C). * * * "[16]

The IRS Answered Additional Questions and Raised Others

Further, the IRS addressed the following question, which the 2010 Report did not pose:

> *[Q] "Are registered domestic partners each entitled to take credit for half of the total estimated tax payments paid by the partners?"*

11 Sept. 16, revised Nov. 16, 2011.

12 As updated August 4, 2012, IRS.gov features three linked articles: *IRS Provides Answers to Community Property Filers*, http://www.irs.gov/uac/IRS-Provides-Answers-to-Community-Property-Filers; *Answers to Frequently Asked Questions for Same-Sex Couples*, http://www.irs.gov/newsroom/article/0,,id=258326,00.html [hereinafter *FAQs*] (listing eight FAQs); *Questions and Answers for Registered Domestic Partners and Same-Sex Spouses in Community Property States*, http://www.irs.gov/uac/Questions-and-Answers-for-Registered-Domestic-Partners-and-Same-Sex-Spouses-in-Community-Property-States [hereinafter *Q&As*] (listing 21 Q&As).

13 National Taxpayer Advocate 2010 Annual Report to Congress 211, 215.

14 FAQs, *supra* note 12, at 8th FAQ.

15 National Taxpayer Advocate 2010 Annual Report to Congress 211, 215.

16 *Q&As*, *supra* note 12, at 3rd Q&A.

> [A] "Unlike withholding credits, which are allowed to the person who is taxed on the income from which the tax is withheld, a registered domestic partner can take credit only for the estimated tax payments that he or she made."[17]

While the Q&As confirm, as a matter of federal tax law, allocation of withholding credit to the partner taxed under state community property law, the IRS has rejected e-filed returns where the withholding exceeds that on Forms W-2. For example, a California domestic partner may have to file as single for federal tax purposes but nonetheless pay tax on half her partner's earnings. Accordingly, the taxpayer may claim credit for the requisite withholding on the partner's, rather than her own, Form W-2. However, IRS systems have not been able to connect the taxpayer's return with the partner's Form W-2 because they are not married, resulting in automatic, electronic rejection. To avoid this problem, the IRS needs to establish a process that will allow e-filing.[18] Consequently, revisions of the relevant forms to cross-reference partner returns are pending in the IRS.

Although the informal guidance solves some problems that have arisen since 2010, it raises even more questions about others. For example, a frequently asked question (FAQ) clarifies the application of the adoption credit to same-sex parents:

> *[Q] "If a taxpayer adopts the child of his or her same-sex partner as a second parent or co-parent, may the taxpayer ("adopting parent") claim the adoption credit for the qualifying adoption expenses he or she pays or incurs to adopt the child?"*
>
> [A] "Yes. The adopting parent may claim an adoption credit to the extent provided under the law. The law does not allow taxpayers to claim an adoption credit for expenses incurred in adopting the child of the taxpayer's spouse. However, this limitation does not apply to adoptions by same-sex partners because same-sex partners, even if married for state law purposes, are not treated as spouses under federal law."[19]

On the other hand, a Q&A takes a controversial legal position:

> *[Q] "How should registered domestic partners report Schedule C [Profit or Loss from Business (Sole Proprietorship)] income that is community property?"*
>
> [A] "Half of the income, deductions, and net earnings of a business operated by a registered domestic partner must be reported by each registered domestic partner on a Schedule C (or Schedule C-EZ). In addition, each registered domestic partner owes self-employment tax on half of the net earnings of the business. Although the self-employment tax rules contain a provision that overrides community income

17 *Q&As*, *supra* note 12, at 9th Q&A.

18 On rejected e-filing, see *supra* Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying Processing of Refunds that Trigger Systemic Filters.*

19 *FAQs*, *supra* note 12, at 6th FAQ.

> treatment in the case of spouses (section 1402(a)(5) of the Internal Revenue Code), this provision does not apply to registered domestic partners."[20]

Sole proprietors do not split self-employment income, even in community property states, under a general definition that this is "the gross income derived by an individual from any trade or business carried on by such individual."[21] Specifically, the law indicates that business income that is community property shall be treated as that "of the spouse carrying on such trade or business."[22]

Literally, this provision would not apply to same-sex couples, who cannot be recognized as spouses under DOMA, even if they have community property. Yet the general rule still would impose self-employment tax only on the individual carrying on the business. In a peculiar twist of logic, the IRS appears to have concluded that because the specific provision for spouses does not apply, an opposite result — rather than the general rule — prevails.

Historically, the specific spousal provision had contained a presumption in favor of the husband as owner of business income that courts struck as unconstitutional in 1980.[23] In the absence of an operative spousal provision, the IRS then ruled that business income under community property belonged to "the person carrying on the trade or business."[24] In 2004, Congress effectively codified this result.[25] It is unclear why the IRS could not issue a similar ruling now that same-sex partners are in an analogous position in which the spousal provision is inoperative for them. Even if the IRS will not issue a similar ruling, it remains unclear why a Q&A, rather than authoritative rulemaking, would be the proper means to resolve this legal interpretation.[26] Instead, commentators have complained about the current anomaly in which a same-sex community property owner is uniquely subject to self-employment tax even if not working in the business.[27]

Taxpayers Need Further Guidance.

While the IRS has answered several questions, a few specific questions from the 2010 Report remain outstanding:

> "Is alimony under state domestic partnership or same-sex marriage law includible by the recipient and deductible by the payer?

20 *Q&As*, *supra* note 12, at 7th Q&A.

21 IRC § 1402(a).

22 IRC § 1402(a)(5).

23 *See Carrasco v. Sec'y of Health, Educ'n & Welfare*, 628 F.2d 624, 629 n. 7 (1st Cir. 1980).

24 Rev. Rul. 82-39, 1982-1 C.B. 119.

25 *See* Pub. L. No. 108-203.

26 On vehicles for legal guidance, *see* 26 C.F.R. § 601.201.

27 *See Practitioner Group Seeks Revisions to Publication on Community Property*, 2011 Tax Notes Today 48-15 (Mar. 2, 2011).

"Is community property created upon marrying or partnering with an individual of the same sex a taxable gift?

"Do same-sex tenants by the entirety have a qualified joint interest for estate tax purposes?"[28]

Meanwhile, the following issues have arisen or remain unanswered: How can an insurance company comply with federal tax law concerning favorable pay-outs from annuity contracts or qualified plans to surviving spouses in a state that recognizes same-sex marriage?[29] A state insurance commissioner could preclude an insurance company from offering contracts or plans that would discriminate against same-sex spouses recognized in the state.[30] However, a non-discriminatory contract or plan could run afoul of DOMA for federal tax purposes.

Another question arises if a court places a child with the parent's same-sex partner — who may be precluded from adoption in certain states. Would that come within the definition of "eligible foster child," meaning "an individual who is placed with the taxpayer by . . . judgment, decree, or other order of any court of competent jurisdiction" for tax dependency purposes?[31] Literally, a court may place the child, if not with a traditional foster parent, with a same-sex parent. Thus, the terms of the definition could apply to changing social and legal circumstances. Currently, the only reason to deny the dependency deduction would be failure to recognize the parental role of the partner. In short, ongoing questions require further guidance.

The IRS Should Prepare for Questions.

While commentators may perceive any guidance as partisan, taxpayers need clarity, which they may prefer over uncertainty even if the result is unfavorable. Uncertainty leads to taxpayer burden, disputes, and litigation, ultimately eroding compliance and confidence in the IRS.[32]

The Supreme Court has granted a *writ of certiorari* concerning same-sex marriage for a potential decision in the summer of 2013.[33] Although questions may be premature, taxpayers are already asking what happens if DOMA lapses. If the Supreme Court finds a constitutional flaw in the statute, would that finding be retroactive? Could same-sex spouses

28 National Taxpayer Advocate 2010 Annual Report to Congress 211, 215. As cited above, the Justice Department has argued, and the courts have agreed, that an estate tax arising only if the surviving spouse is the same sex as the decedent represents unconstitutional discrimination. *See Windsor v. U.S.*, 833 F.Supp.2d 394 (S.D.N.Y. 2012), *aff'd* No. 12-2335 (2nd Cir. Oct. 18, 2012).

29 *See* IRC §§ 72(s) & 401(a)(9) (generally allowing spouses longer deferral than other beneficiaries).

30 *See* Mark E. Griffin, *Conflicting Definitions of "Spouse" Under DOMA and State Law*, 6 Taxing Times (Soc'y of Actuaries) 13, 15 (May 2010).

31 *See* Fla. Stat. § 63.042(2)(a) (limiting joint adoption to husband and wife); Miss. Code § 93-17-3 (disallowing adoption by same-sex couples); Utah Code § 78B-6-117 (prohibiting adoption "by a person who is cohabiting in a relationship that is not a legally valid and binding marriage"); IRC § 152(f)(1)(C) (defining "eligible foster child").

32 *See* Scott James, *From IRS to Gay Couples, Headaches and Expenses*, NY Times (June 12, 2011).

33 *See* Adam Liptak, *Supreme Court to Take up Gay Marriage*, NY Times (Dec. 7, 2012).

amend their returns to file jointly? Conversely, would same-sex spouses who had avoided federal marriage penalties be held harmless? What would be the federal filing status of same-sex spouses legally married in one state but residing in a different state that does not recognize their marriage?[34] Either way that the Supreme Court rules on DOMA, there will be federal tax questions.

CONCLUSION

In an evolving legal landscape, the IRS has issued answers about domestic partners and same-sex spouses, but more questions have arisen. Despite requests, the IRS has yet to publish comprehensive, authoritative guidance. Failure to render guidance on the fundamental question of the taxable unit of more than one million individuals impairs tax administration.[35] In conclusion, the National Taxpayer Advocate again recommends that the IRS publish clarifying guidance, rules, and regulations when taxpayers need answers.

34 *Cf.* Rev. Rul. 58-66, 1958-1 C.B. 60 (recognizing common-law marriage of taxpayers "who later move into a state in which a ceremony is required to initiate the marital relationship"); Restatement of Conflict of Laws § 121 (stating general rule that marriage is valid if recognized where celebrated).

35 *See* Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389 (1975) (discussing fundamental questions of taxation of the family unit).

Status Update: The IRS's Reliance on Automated "Enforcement Assessments" Has Declined Significantly, but Concerns Remain

RESPONSIBLE OFFICIALS

Faris Fink, Commissioner, Small Business/Self-Employed Division
Peggy Bogadi, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

In the 2011 Annual Report to Congress, the National Taxpayer Advocate expressed concerns about the IRS's wholesale use of automated "enforcement assessments" such as the Automated Substitute for Return (ASFR) program.[1] This report detailed the ASFR program's artificially-inflated assessments and low collection percentages, which lead to wasted IRS resources.

The report identified a need to improve the automated selection process to reduce taxpayer burden, and to enhance customer service options such as telephone contacts prior to finalizing assessments to resolve more ASFR cases early in the process. The National Taxpayer Advocate recommended a number of improvements to the ASFR program, such as revising procedures to emphasize personal contact with taxpayers prior to assessment, and applying a pre-assessment "collectibility" determination to all potential ASFR assessments.[2]

In fiscal year (FY) 2012, the IRS's use of ASFR assessments decreased dramatically from prior years. The number of assessments fell by 50 percent from FY 2011,[3] while dollars assessed declined 54 percent.[4] This Status Update explores possible reasons for the decrease.

ANALYSIS OF PROBLEM

The Automated Substitute for Return Program Is a Key Tool for Enforcing Filing Compliance.

ASFR is the key program for enforcing filing compliance by taxpayers who have not filed individual tax returns, but have incurred a "significant" tax liability.[5] The program estimates the liability by computing tax, penalties, and interest based upon information reported to the IRS by third-party payers. When a taxpayer with reported income is delinquent in filing a return, the IRS attempts to secure the return through correspondence.

1 *See* National Taxpayer Advocate 2011 Annual Report to Congress 93 (Most Serious Problem: *Automated "Enforcement Assessments" Gone Wild: IRS Efforts to Address the Non-Filer Population Have Produced Questionable Business Results for the IRS, While Creating Serious Burden for Many Taxpayers*); *see also* National Taxpayer Advocate 2007 Annual Report to Congress 246 (Most Serious Problem: *Nonfiler Program*).

2 *See* National Taxpayer Advocate 2011 Annual Report to Congress 108 (Most Serious Problem: *Automated "Enforcement Assessments" Gone Wild: IRS Efforts to Address the Non-Filer Population Have Produced Questionable Business Results for the IRS, While Creating Serious Burden for Many Taxpayers*).

3 IRS, Collection Activity Report NO-5000-139, *National Delinquent Return Activity Report* (Sept. 2011-2012).

4 *Id.*

5 Internal Revenue Manual (IRM) 5.18.1.2 (Oct. 1, 2005). To meet ASFR processing criteria, the proposed tax liability must meet or exceed a predetermined dollar threshold.

If the attempt is unsuccessful, the IRS is authorized by the Internal Revenue Code (IRC) to prepare a substitute return for the taxpayer.[6]

The ASFR Program Has Proven to Be an Inefficient Use of IRS Resources, and It Artificially Inflates Assessments.

Since its inception, the ASFR program has been the subject of much analysis. As early as 1991, the IRS determined that "only a small percentage of the (ASFR) dollars and modules are collected during the assessment process and notice routine. More should be done in determining collectibility prior to making the (ASFR) assessment."[7]

In 1998, another IRS report concluded:

> The IRS needs to place much greater emphasis on establishing contact with the taxpayers represented in the ASFR inventory, obtaining 'agreed' assessments for the tax years in question, and resolving all aspects of the taxpayers' delinquency problems, including collection, through one stop service.[8]

In the 2007 Annual Report to Congress, the National Taxpayer Advocate identified similar concerns with the ASFR program's "high default assessments, low collection percentages, and significant downstream consequences in the form of TAS casework."[9]

By FY 2011, the number of ASFR-generated returns had increased to eight times the number in FY 2002 (see Figure 1.S3.1).[10]

6 Internal Revenue Code (IRC) § 6020(b).

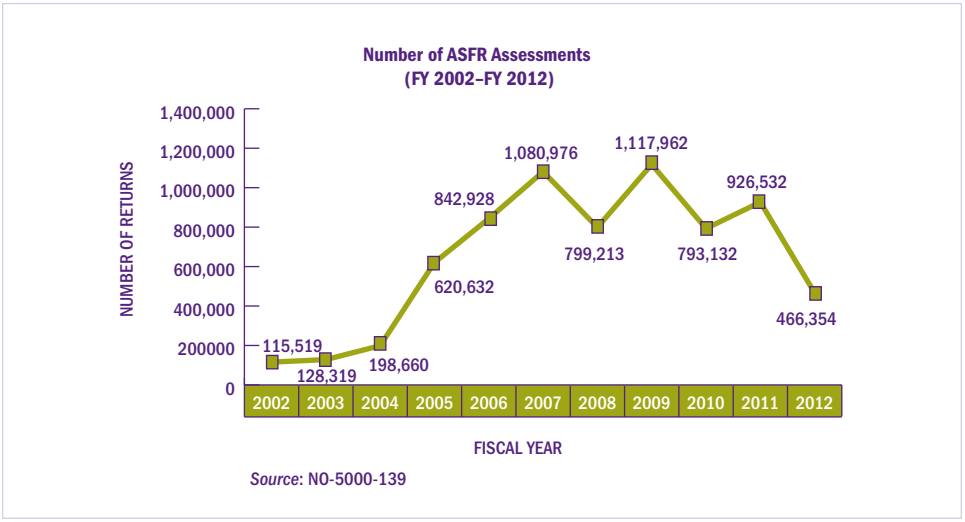
7 IRS, *Currently Not Collectible Study Group Report* 82 (Feb. 1991).

8 IRS, *Automated Substitute for Return (An Analysis from the Customer's Perspective)* 3 (Nov. 1998).

9 National Taxpayer Advocate 2007 Annual Report to Congress 246 (Most Serious Problem: *Nonfiler Program*).

10 IRS, Collection Activity Report NO-5000-139, *National Delinquent Return Activity Report* (2002 - 2011).

FIGURE 1.S3.1, ASFR Assessments (FY 2002–FY 2012)

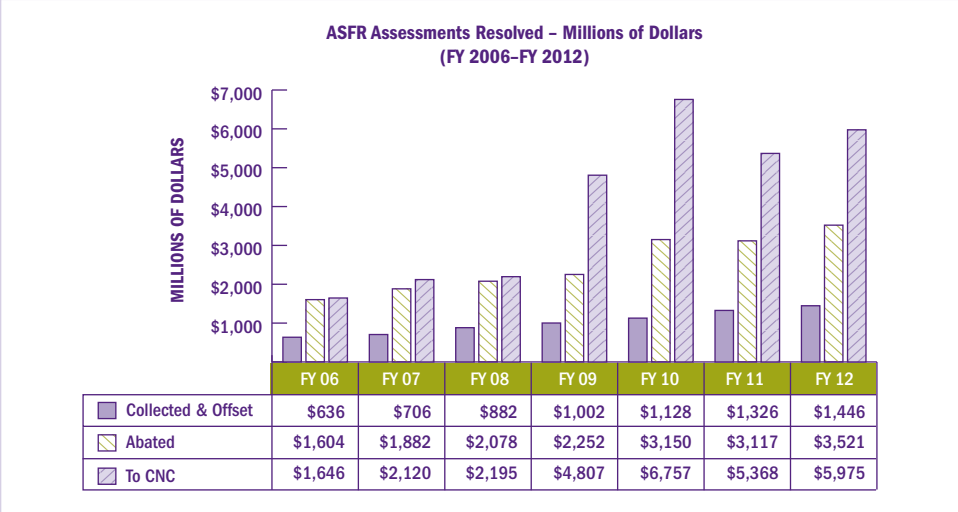


Source: NO-5000-139

The National Taxpayer Advocate's 2011 Annual Report to Congress pointed out that the IRS actually collected less than ten percent of the ASFR assessments from FY 2006 through FY 2011.[11] Moreover, the IRS abates or reports as currently not collectible a significant percentage of these accounts (see Figure 1.S3.2).

11 See National Taxpayer Advocate 2011 Annual Report to Congress 97 (Most Serious Problem: *Automated "Enforcement Assessments" Gone Wild: IRS Efforts to Address the Non-Filer Population Have Produced Questionable Business Results for the IRS, While Creating Serious Burden for Many Taxpayers*).

FIGURE 1.S3.2, ASFR Program Results (FY 2006–FY 2012)



	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12
Collected & Offset	$636	$706	$882	$1,002	$1,128	$1,326	$1,446
Abated	$1,604	$1,882	$2,078	$2,252	$3,150	$3,117	$3,521
To CNC	$1,646	$2,120	$2,195	$4,807	$6,757	$5,368	$5,975

ASFR Assessments Decreased Dramatically in FY 2012.

In FY 2012, the IRS made 466,354 ASFR assessments, compared to 926,532 in FY 2011,[12] which represents a 50 percent decrease.[13] Correspondingly, the ASFR dollars assessed in FY 2012 decreased at a similar rate. The IRS made approximately $6.7 billion in ASFR assessments in FY 2012, down 54 percent from $14.4 billion in FY 2011.[14]

Possible Reasons for the Decrease in ASFR Assessments.

Clearly, the IRS made significant adjustments to the ASFR program in FY 2012. Reductions in ASFR assessments appear to have started in December 2011 and carried forward throughout the year.

The IRS has acknowledged that some of the adjustments were resource-driven (*i.e.*, the IRS opened fewer ASFR cases so the available staff could handle the workload in a timely manner). Additionally, the IRS has initiated a new practice that limits the number of ASFR returns assessed at one time on the same taxpayer. Finally, the IRS no longer initiates an ASFR assessment if the taxpayer already has a balance due for another tax year.

Although these adjustments appear to represent prudent business decisions, the IRS has not yet made the changes recommended in the 2011 Annual Report, which the National Taxpayer Advocate believes are still necessary. Placing more emphasis on pre-assessment contacts with taxpayers, and ending the practice of making ASFR assessments in cases

12 IRS, Collection Activity Report NO-5000-242, *Type Assessment Cumulative Report, Part 1* (2006-2012).

13 IRS, Collection Activity Report NO-5000-139, *National Delinquent Return Activity Report* (Sept. 2011-2012).

14 *Id.*

where the IRS has no confirmed address for a taxpayer would protect taxpayer rights, improve service, and maximize the benefits of IRS resources.

The IRS has informed us of its plan to implement an additional return delinquency notice for potential ASFR cases in FY 2013, which will be issued prior to ASFR processing. The IRS believes this notice will afford taxpayers additional time to respond, and may result in delinquent returns being filed without the need for ASFR assessments. The systemic changes associated with the implementation of this notice will also provide for additional telephone number and address research prior to ASFR processing, and will facilitate the testing of the potential benefits of using new technology in ASFR case processing.

The Taxpayer Advocate Service Will Study the Effectiveness of the ASFR Program.

In FY 2013, TAS Research will conduct an analysis to determine the results of ASFR assessments made after receiving notification that the ASFR letters were returned as undeliverable. The study will analyze dollars collected and case resolution type in addition to subsequent voluntary filing and payment compliance. If the analysis indicates the IRS collects less money on assessments and has less effective case resolutions when the taxpayer's mail is undeliverable, TAS will recommend testing a sample of ASFR casework to determine if additional attempts at personal contact will result in more accurate assessments and more dollars collected.

Additionally, we will explore what happens to ASFR cases that are transferred to the collection queue within one year of assessment. We will compare the dollars collected and case resolution type in these cases to ASFR assessments in which the IRS uses other collection streams.

CONCLUSION

The IRS has reduced its reliance on the ASFR assessments in FY 2012. However, the National Taxpayer Advocate still has serious concerns about the effectiveness of this program. While ASFR assessments may generate considerable potential accounts receivable, by design these assessments generally represent balances due that are artificially inflated and misleading. Further, we continue to find little evidence that this approach is effective in actually collecting delinquent revenue or promoting future compliance by the affected taxpayers.

The National Taxpayer Advocate reiterates the recommendations in the 2011 Annual Report to Congress that the IRS:

1. Reinstate the policy of not making automated enforcement assessments without confirming the taxpayer's address of record is valid, and require use of Form 4759, *Postal Tracer*, to confirm addresses prior to assessments in all "unagreed — no contact" situations.

2. Revise ASFR processing procedures to emphasize the completion of telephonic, personal contacts with the affected taxpayers in all potentially "unagreed" ASFR cases prior to assessment.
3. Allocate adequate resources to the ASFR reconsideration process to ensure adjustments are initiated and completed in a timely manner.
4. Apply a pre-assessment collectibility determination to all potential ASFR assessments, including consideration of potential "unable to locate" and "little or no tax due" situations, and the potential for economic hardship based on the taxpayer's income level. Consider the taxpayer's last-filed return information in making this determination.

Status Update: The IRS Has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance

RESPONSIBLE OFFICIALS

Steven T. Miller, Deputy Commissioner, Services and Enforcement
Beth Tucker, Deputy Commissioner, Operations Support

DEFINITION OF PROBLEM

Virtual face-to-face (VFTF) service delivery enables taxpayers to interact directly with IRS employees using videoconferencing equipment. While video service will not replace traditional face-to-face service, using it to enhance and expand existing service will allow the IRS to reach taxpayers in more remote areas of the country and those with mobility issues. VFTF also will provide face-to-face interaction where the IRS now offers only automated service or correspondence. Taxpayers can benefit from having their issues and their rights explained to them personally, their documents reviewed instantly, and the opportunity to ask follow-up questions in real time, while the IRS can benefit by eliminating rework and reducing case processing time.

The IRS and TAS began pilot testing one form of VFTF service in fiscal year (FY) 2012, during which time the IRS served over 12,500 taxpayers through virtual service stations.[1] Eighty-six percent of taxpayers surveyed on their experience with the Wage and Investment (W&I) Division pilot reported they were satisfied or very satisfied with the service, and 91 percent would use it again.[2]

Despite this promising beginning, competing priorities may impede the ability of the IRS to focus appropriately on a VFTF service strategy that encompasses research into the proper technology, thereby preventing a more robust use of VFTF and limiting the types of services provided. Providing resources and a directive to expand VFTF service as a way for citizens to interact with their government should be a priority of Congress. Given adequate resources and a choice to make expanding VFTF services a priority, the IRS could work to place video stations in existing IRS locations or partner facilities and expand the capability of current equipment, enabling taxpayers and their representatives to interact securely with IRS employees via personal computers or mobile devices. In the deployment of VFTF technology, however, the IRS must be careful not to rely too heavily on virtual services at the expense of its traditional local, geographically positioned expertise.

1 IRS, *Field Assistance Virtual Delivery Service (VSD) W&I Research and Analysis Report*, iv (August 2012). W&I served 12,469 taxpayers during the pilot. Appeals served 11 taxpayers through Sept. 14, 2012. IRS response to TAS research request (Sept. 14, 2012). TAS served 68 taxpayers through August 31, 2012. Receipt volume from Taxpayer Advocate Management Information System (TAMIS) (Sept. 2012). Total number of taxpayers served was 12,548. Customer Satisfaction rates for VFTF were similar to rates for taxpayers receiving in-person service in TACs.

2 IRS, *Field Assistance Virtual Delivery Service (VSD) W&I Research and Analysis Report,* iv (August 2012).

ANALYSIS OF PROBLEM

Background

Certain taxpayers need or prefer to receive services in a face-to-face environment.[3] However, reaching all segments of the population through Taxpayer Assistance Centers (TACs) or in-office appointments may not be possible due to space and budgetary constraints. For this reason, the National Taxpayer Advocate has previously recommended that the IRS test virtual service delivery to bring a type of face-to-face service to more taxpayers.[4] Such a program would:

- Expand face-to-face options for taxpayers who live in areas not served by TACs or other IRS sites;
- Assist taxpayers with limited mobility; and
- Give taxpayers with tax disputes a real-time interaction with an IRS employee to resolve their issues.

In FY 2012, TAS and the IRS began pilots of VFTF service delivery. The pilots' goals were to seek service delivery alternatives outside of IRS facilities, enhance utilization of IRS resources, optimize staffing, balance workload, and increase access to face-to-face service where it presently was not available.

In building the pilot, the IRS studied the success of the virtual program implemented by the Social Security Administration (SSA). The SSA identified a gap in its ability to provide face-to-face services to Native American reservations due to distance, travel limitations, and bad weather. Without face-to-face contact, understanding of SSA programs was limited. To help close this gap, the SSA established videoconferencing between SSA offices and six reservations in the western United States.[5] The program has since expanded to more than 70 locations, with plans to bring videoconferencing to the nine other SSA regions, in addition to using the technology to reach U.S. citizens abroad and collaborating with the Department of Veterans Affairs to assist disabled veterans returning from war.[6] This technology has allowed the SSA to enhance services to citizens and to reach previously underserved target groups. The SSA is also using videoconferencing technology to conduct disability hearings with applicants in the office of the applicant's attorney. Through software made available to representatives, an applicant can connect directly to an SSA employee during the hearing.

3 See IRS Oversight Board, *Taxpayer Customer Service and Channel Preference Survey Special Report* (Nov. 2006); National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, 1-15 (*Study of Taxpayers' Needs, Preferences, and Willingness to Use IRS Services*).

4 See National Taxpayer Advocate 2010 Annual Report to Congress 267-277 (Most Serious Problem: *The IRS Has Been Reluctant to Implement Alternative Service Methods that Would Improve Accessibility for Taxpayers Who Seek Face-to-Face Assistance*); and National Taxpayer Advocate 2008 Annual Report to Congress 95-113 (Most Serious Problem: *Taxpayer Service: Bringing Service to the Taxpayer*).

5 IRS, *Virtual Service Delivery: Delivering Taxpayer Services Using Video Communications Technology* (July 2011).

6 *Id.*

State governments, other federal agencies, and foreign governments also are successfully using video technology to interact with their citizens. For example, Iowa is providing education, reuniting troops in war zones with their families, and bringing doctors to patients in underserved rural areas.[7] Members of Congress use Skype and ooVoo to conduct official business with constituents,[8] and lawyers in Singapore are trying cases in e-court using video conferencing.[9] The Department of Veterans Affairs is also using video conferencing technology in conjunction with the SSA to aid returning veterans from Afghanistan and Iraq.[10]

Virtual Service Delivery is being tested across the IRS and TAS with positive results. In FY 2012, W&I piloted VFTF in ten IRS offices and two partner sites.[11] The IRS Office of Appeals also tested VFTF to connect Memphis and Fresno Campus Appeals officers with Low Income Taxpayer Clinics (LITCs) in Tennessee and Washington State.

W&I tested VFTF service delivery in 12 locations, providing a limited number of the services normally offered at brick and mortar TACs. The pilot period, which ran from October 2011 until June 2012, served nearly 12,500 taxpayers and offered an alternative form of service in offices that had a large volume of customers, were unstaffed or staffed only at certain times of the year, or were located in an external partner's location.[12] Eighty-six percent of taxpayers reported they were satisfied or very satisfied with this service, and 91 percent would use it again.[13]

TAS participated in the IRS pilot from December 2011 through August 2012 by connecting its office in Jacksonville, Florida, to a TAC in Tampa (where TAS has no local office). TAS has served nearly 70 taxpayers as of August 31, 2012, with employees discussing tax problems, opening cases for those who met TAS criteria, and providing updates on cases TAS was already working.[14] All of those who responded to TAS's customer service survey agreed or strongly agreed that that they would be willing to use video technology again and would recommend it to others.[15]

Appeals tested VFTF service delivery by working with two LITCs from April 2012 through October 2012 for Collection Due Process and offer in compromise cases. Taxpayers could come to the test sites and work with an LITC representative to conduct a hearing with

7 Iowa Communications Network, *available at* http://www.icn.state.ia.us/aboutus/icn_story/index.html (last visited on September 2, 2012).

8 Press Release, Committee on House Administration, House Network Now Supports Skype and ooVoo Video Teleconferencing (June 28, 2011), http://cha.house.gov/press-release/house-network-now-supports-skype- and-oovoo-video-teleconferencing.

9 International Bar Association, Richardson, Frank, *The E-Justice Revolution*, *available at* http://www.ibanet.org/ (last updated Oct.15, 2010).

10 IRS, *Virtual Service Delivery: Delivering Taxpayer Services Using Video Communications Technology* (July 2011).

11 IRS, *Virtual Service Locations*, *available at* http://www.irs.gov/pub/newsroom/vsd.pdf (last visited September 2, 2012).

12 IRS, *Field Assistance Virtual Delivery Service (VSD) W&I Research and Analysis Report*, iv (August 2012).

13 *Id*.

14 Receipt volume from TAMIS (Sept. 2012).

15 Only nine TAS customers responded to the customer survey, which resulted in a sample size that could not be projected to the entire pilot population.

Appeals. The Appeals pilot has not yet concluded, and as a result, TAS is awaiting the outcome of the surveys administered during the pilot.

The IRS and TAS plan to expand the VFTF service delivery pilot in FY 2013. The IRS and TAS will expand VFTF sites in FY 2013 to encompass over 20 locations.[16] Several of the sites will include both TAS and IRS services in order to maximize the impact of services offered to taxpayers. The new sites will include W&I and SB/SE compliance services as well as additional W&I Field Assistance services, TAS services, and Appeals services. Sites will be located at IRS and non-IRS buildings.[17] Additionally, the IRS will upgrade the equipment available in many VFTF sites to allow for higher resolution document cameras to enhance the ability of employees to review taxpayer documents in real time.[18]

TAS is very encouraged by the results of the VFTF pilots and anticipates additional success as the IRS expands the program with additional services in FY 2013. The National Taxpayer Advocate applauds the IRS efforts to expand VFTF service and encourages the IRS to continue pursuing additional strategies that will allow taxpayers to use their personal computers or mobile devices to interact with the IRS.

The IRS should explore offering additional VFTF services to meet taxpayer needs and enhance taxpayer rights.

While the VFTF services initially deployed through W&I have been extremely successful, failure to adopt appropriate technology prohibits the IRS from offering a full range of services in this environment. Taxpayers using the VFTF sites cannot make a payment, file a return, obtain account transcripts, or interact with IRS employees other than W&I TAC staff. The IRS is exploring technology that will allow taxpayers to accomplish these and other routine tasks, with multiple IRS organizations sharing the technology and routing video to the correct location. VFTF technology will help all taxpayers who are willing and able to use the services, especially those who live far from traditional face-to-face locations, have limited mobility, face issues of functional literacy when confronted with IRS correspondence, or lack representation. Not offering a full range of services in a virtual environment will prevent taxpayers from accomplishing everything they could do in a traditional IRS building. Funding is the key issue in advancing the technology and the number of locations where VFTF is offered.

Allowing taxpayers and their representatives to use their personal computers or mobile devices to engage in VFTF activities could reduce taxpayer burden in many IRS interactions.

16 IRS, *Virtual Service Delivery: Delivering Taxpayer Services Using Video Communications Technology* (Oct. 2012). Several sites overlap between IRS operating divisions and TAS.

17 New proposed sites may be located in Helena, MT, Roswell, NM, Davenport, IA, Alexandria, LA, Little Rock, AR, Pensacola, FL, Boise, ID, Beaumont, TX, Farmington, NM, Waterloo, IA, Tupelo, MS, San Diego, CA, El Paso, TX, Anchorage, AK, Wichita, KS, Billings, MT, Nome, AK, Staten Island, NY, Flagstaff, AZ, Lake Havasu, AZ, Clarksdale, MS, and Spokane, WA or Coeur d'Alene, ID. IRS, *Virtual Service Delivery: Delivering Taxpayer Services Using Video Communications Technology* (Oct. 2012).

18 *Id.*

For example, the IRS could use videoconferencing to conduct "office" audits with taxpayers or their representatives. Such technology could also assist elderly or disabled taxpayers who may face difficulties leaving their homes to meet with a Tax Compliance Officer. Web-based videoconferencing would allow taxpayers or representatives to meet with IRS employees from their own homes or offices, respectively, using their own computers or mobile devices.

Expanding VFTF services to international locations would allow the IRS to address the service needs of taxpayers who live abroad.[19] Currently, taxpayers living abroad only have access to face-to-face services via four international tax attaches located in Frankfurt, Paris, London, and Beijing.[20] These offices have limited hours and two are open for face-to-face services by appointment only.[21] Additionally, services offered by the attaché offices are limited to obtaining tax forms and publications, addressing account problems, and answering questions about notices and bills.[22] International taxpayers have indicated a strong preference for the IRS to improve online services, including interactive options.[23] Opening even one VFTF site internationally would exponentially increase the IRS presence for taxpayers abroad and would allow these taxpayers access to the face-to-face services offered to taxpayers in the U.S.

Testing VFTF for correspondence exams is a step in the right direction.

The IRS should use VFTF to make more services available in a face-to-face environment that have generally been available only by telephone or correspondence. In FY 2011, the IRS conducted 75 percent of its individual audits by correspondence, which does not allow the taxpayer a personal interaction with the IRS to understand how to resolve the issue.[24] The National Taxpayer Advocate is pleased that the IRS will begin testing the use of VFTF correspondence exams in FY 2013. Moving these exams from correspondence to VFTF will:

- Allow the taxpayer to work with a single point of contact at the IRS;
- Permit the taxpayer to have his or her issue explained clearly face-to-face;
- Enable the employee to examine the taxpayer's documents and determine immediately whether more information is necessary; and
- Allow the taxpayer to ask questions about how to resolve the issue and receive an instant response.

19 For further discussion of the National Taxpayer Advocate's concerns about service to international taxpayers, *see* Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*, *supra*.

20 IRS, *Contact My Local Office Internationally*, *available at*: http://www.irs.gov/uac/Contact-My-Local-Office-Internationally (last visited Nov. 7, 2012).

21 *Id*.

22 *Id*.

23 IRS, Wage and Investment Division (W&I) Research & Analysis, *Research Study Report, 2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* (Aug, 2012) (2012 WIRA Research Study). Sixty-nine percent of respondents to the IRS survey indicated they would prefer that the IRS expand and improve online services over phone services.

24 IRS, *Fiscal Year 2011 Enforcement and Service Results* 3.

The National Taxpayer Advocate has previously detailed her concerns about the lack of personal communication with taxpayers during the correspondence exams process.[25] A 2004 TAS survey revealed that 17 percent of taxpayers who requested an audit reconsideration due to communication difficulties, and were audited because they claimed the Earned Income Tax Credit (EITC), were not even aware of the initial exam.[26] When taxpayers do not even know they are being audited, the IRS cannot help them understand and participate in the exam. Relying heavily on correspondence exams particularly impacts taxpayers who lack representation, are not functionally literate, or do not speak English as a first language. Using VFTF service to conduct these exams would protect taxpayer rights and particularly vulnerable taxpayer populations. The National Taxpayer Advocate anticipates a successful pilot of VFTF service in W&I correspondence exams in FY 2013 and looks forward to the expansion of this service.

The IRS and TAS face challenges in deploying VFTF service.

The IRS needs a clear strategy that defines how it can use video technology, including collaborating within the IRS, with other federal agencies, and external partners, to expand services to citizens. The IRS also needs a mobile technology strategy. Providing quality face-to-face services, especially in program areas where taxpayers often face confusion, must be a strategic priority for Congress and the IRS. A clear strategy should address training, privacy, and security issues to ensure the IRS can continue to move forward with this critical initiative.

Training employees to work in this new environment, especially in areas where the IRS has not previously offered face-to-face service, is imperative. Employees will need to learn how to speak with taxpayers in a manner that allows taxpayers to be comfortable with the interaction while still addressing the taxpayer's and the IRS's needs.

In addition, using the Internet to interact with taxpayers raises concerns about the security of sensitive information. The IRS must address the security of any personally identifiable information as part of its efforts to develop a web-based VFTF solution accessible from computers and mobile devices. Taxpayers must be assured that virtual service is just as secure as traditional service options.

While these obstacles exist, they can be overcome. The IRS can continue to learn from SSA and other agencies in these areas, and should study existing Internet security products to determine if they meet IRS needs. While preparing new VFTF sites, the IRS can develop and present training so employees will be ready when the sites come online. Congress

25 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 63-90 (*An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); *and* National Taxpayer Advocate 2009 Annual Report to Congress 158-167. Similarly, the National Taxpayer Advocate has concerns about Automated Collection System (ACS) processes and the impact on taxpayers who are not afforded the opportunity to address concerns in a face-to-face environment. For further discussion of the National Taxpayer Advocate's concerns about ACS, see Most Serious Problem: *The Automated Collection System Can Become More Productive and Resolve More Case by Improving Customer Service and Diversifying its Case Inventory*, *supra*.

26 National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 20-21 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

can assist the IRS by specifically allotting funds for VFTF services and directing the IRS to offer more services to more taxpayers, thus enhancing taxpayer rights and promoting voluntary compliance.

CONCLUSION

VFTF service is not a substitute for traditional face-to-face service. However, it can be a supplement or alternative to TAC services, especially for taxpayers who live far from a TAC or have limited mobility. The IRS can address longstanding concerns about the efficacy of automated or centralized enforcement activity by expanding face-to-face service to new areas such as offers -in -compromise and Appeals hearings, via personal computing devices. Improved technology would help the IRS to offer a full range of services, which in turn could help taxpayers understand the solutions to their tax issues at their first contact, thereby avoiding multiple contacts to resolve the same issue.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that:

1. The IRS continue to study and propose areas where VFTF delivery options would benefit taxpayers.
2. The IRS immediately identify international locations for VFTF sites and expand VFTF to taxpayers abroad.
3. Congress provide funding specifically to allow the IRS and TAS to expand VFTF service using broadband and mobile technology as a way for citizens to interact with their government.
4. The IRS pursue strategic solutions that would allow taxpayers to interact with IRS employees on their home computers or mobile devices.

Status Update: The IRS Has Improved Training and Procedures to Account for Collection Statute Expiration Dates

RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division
Faris Fink, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

By statute, the IRS generally has ten years from the assessment of a tax to collect it before the statutory period expires, unless the taxpayer extends the period by waiver or a provision suspends the period.[1] At the urging of the National Taxpayer Advocate, the IRS:

- Has improved its training and tools for employees to account for the collection statute expiration dates (CSEDs) provided by law;
- Is developing new methods of calculating CSEDs; and
- Is attempting to resolve accounts with CSED waivers of more than six years, which is the current time limit on extensions.

TAS received 89 CSED cases in fiscal year (FY) 2012, a decline of 40 percent from FY 2011.[2] However, the Treasury Inspector General for Tax Administration (TIGTA) reviewed a statistically valid sample of accounts involved in IRS collection hearings for FY 2010 and 2011, and determined that over 20 percent of the taxpayer accounts subject to these hearings had an inaccurate CSED.[3] Further, TAS reviewed a sample of income tax modules from 1995 tax periods that were unabated and unpaid, and determined that 18 percent contained inaccurate CSEDs.[4] Although the number of TAS CSED cases declined in FY 2012, the constant rate of inaccurate CSEDs makes it imperative that the IRS improve its programming and procedures, and dedicate resources to a centralized CSED office to address systemic flaws.

1 Taxpayers may extend the statute by agreement (waiver) in connection with an installment agreement or before releasing a levy after the ten year period. Internal Revenue Code (IRC) § 6502(a). Several code sections provide that the statute may be suspended. *See, e.g.*, IRC §§ 6330(e); 6331(i) & (k); 6503.

2 TAS, year to date receipts to 9/29/2012 by Primary Issue Code (PCIC) and Special Case Code for PCIC 175, CSED. TAS reported 148 cases for FY 2011. PCIC 175 ranked 91st for FY 2012.

3 TIGTA, Ref. No. 2012-10-077, *Additional Improvements Are Needed in the Office of Appeals Collection Due Process Program to Ensure Statutory Requirements Are Met* 7 (July 26, 2012). The IRS Office of Appeals generally holds these Collection Due Process (CDP) hearings, under IRC § 6320 and § 6330, after a taxpayer requests a hearing in writing before an IRS levy or seizure of the taxpayer's assets, or after the IRS has filed its Notice of Federal Tax Lien in the public records for the collection of the taxpayer's liability.

4 IRS, Compliance Data Warehouse (CDW), Individual Master File and Accounts Receivable Dollar Inventory. The modules did have an income tax return filed by September 30, 1996, were not currently in litigation or subject to a pending offer in compromise, and did not have the liability transferred to another module. TAS identified 1,948 of these modules and selected a representative sample of 51 modules. From that sample, TAS recalculated the CSEDs for each module with the CSED calculator and determined that nine modules had miscalculated CSEDs yielding an error rate of 17.6 percent with a margin of plus or minus 8.7 percent at a 90 percent confidence level.

ANALYSIS OF PROBLEM

Background

Since 2004, the National Taxpayer Advocate has urged the IRS to correct CSEDs and its methods of calculating them to prevent unlawful collection actions and harm to taxpayers. Chief among the issues are:

- In the past, certain taxpayers entered into CSED extensions greater than six years, which exceeds present limits; [5]
- IRS employees need training and continuing education to identify and resolve CSED problems;
- The IRS needs to integrate and align its goals for CSED treatment and training in one centralized office to ensure consistency;
- IRS systems and tools to calculate CSEDs are not uniform and lack accuracy;[6] and
- IRS processes to split joint spousal accounts may lead to incorrect CSEDs and possible over-collection.[7]

In response, the Small Business/Self-Employed (SB/SE) and Wage & Investment (W&I) Divisions have offered the following initiatives to address these problems.

TAS and SB/SE Are Addressing Taxpayer Accounts with Extensions Exceeding Current Limits.

SB/SE and TAS formed a workgroup to investigate and correct CSED extensions longer than six years.[8] The group initially determined that 4,466 taxpayers held accounts with extensions exceeding the current limits. IRS Chief Counsel has opined that the IRS cannot "write off" these accounts because taxpayers unilaterally agreed to the extensions.[9] The workgroup is investigating whether it can systemically cease collection and refund offsets of the accounts, or allow certain taxpayers to submit offers in compromise (OICs) to resolve

5 Under current rules, the length of the extension must be based on the time that it will take to make payments under a partial payment installment agreement (PPIA) and cannot exceed five years plus one year to provide for other administrative actions. Internal Revenue Manual (IRM) 5.14.2.1.3(3) (Mar. 11, 2011). Before November 1995, the IRS secured CSED extensions on any account and for any duration provided the CSED was open. IRM 53(11)(1) (Oct. 28, 1993); IRM 5331.1(12)(b)2 (Nov. 2, 1995). It was not uncommon for the CSED to be extended for 25 to 40 years.

6 National Taxpayer Advocate 2010 Annual Report to Congress 339-342 (Status Update: *The IRS's Handling of Collection Statute Expiration Dates Continues to Adversely Affect Taxpayers*); National Taxpayer Advocate, Taxpayer Advocate Directive 2010-3 (Jan. 20, 2010); National Taxpayer Advocate 2009 Annual Report to Congress 217-227 (Most Serious Problem: *IRS Policies and Procedures for Collection Statute Expiration Dates Adversely Affect Taxpayers*); National Taxpayer Advocate 2004 Annual Report to Congress 180-192 (Most Serious Problem: *Erroneous and Miscalculated Collection Statute Expiration Dates*).

7 The IRS manually splits certain joint accounts to track the CSED suspended for one spouse, who takes certain actions (*e.g.*, requesting an offer in compromise (OIC), petitioning for bankruptcy) which suspends the CSED, when the other spouse does not. National Taxpayer Advocate 2009 Annual Report to Congress 275-76 (Most Serious Problem: *The IRS Mismanages Joint Filers' Separate Accounts*). Upon examining a sample of 3,105 Master File Tax (MFT) 31 modules (manually split spousal assessment accounts), TAS estimated that IRS systems reported erroneous CSEDs for approximately 1,100 modules (*i.e.*, 35 percent) that arose when the IRS transferred account data from joint accounts to MFT 31 accounts.

8 The IRS generally provides a Form 900, *Tax Collection Waiver*, for taxpayers to extend the collection statute expiration dates (CSEDs) on their accounts.

9 IRS Office of Chief Counsel, Memorandum to Director, Collection Policy, SB/SE (Feb. 12, 2010).

their accounts.[10] By the end of 2012, IRS systems report that 2,026 taxpayers will hold accounts with these lengthy CSED extensions.[11] The workgroup has engaged the SB/SE Research function to further refine data on these accounts, including identifying taxpayers who have passed away before the CSED expired or have no financial ability to fully pay what they owe within the CSED.[12]

We Commend the IRS for its New CSED Training, But Additional Steps Are Needed to Make the Training Effective.

In April 2012, the IRS produced training for all of its Filing and Payment Compliance employees to:

- Identify transactions that carry their own CSEDs;
- Verify CSEDs for accuracy; and
- Adjust account modules for CSED expiration.[13]

The training manual says, "If an issue with the CSED date is identified, it must be reviewed and verified for accuracy."[14] The training addresses concerns that include referrals of cases with CSED issues, identifying and adjusting CSEDs on accounts with multiple CSEDs, and adjusting accounts to reflect the correct CSED.[15] The IRS plans to conduct training at all of its campuses (processing centers) in FY 2013.[16] The IRS also held a mandatory briefing in its FY 2012 continuing professional education (CPE) for campus employees, and included advanced training for certain employees.[17]

With the new training, the IRS has taken a step toward acknowledging the CSED problem. However, the IRS has removed a CSED-related attribute from quality review standards used by the Field Collection organization. The Embedded Quality (EQ) system provides a standard set of attributes that helps managers and national reviewers to identity trends, problem areas, training needs, and areas that need improvement. The national quality reviewers use the attributes to link overall employee performance to organizational goals.[18] An EQ job aid issued in May 2011 included Attribute 611, which said managers should

10 TAS-SB/SE CSED Workgroup, *Memorandum re: Effective Tax Administration Offers In Compromise for Certain Taxpayers Under a Lengthy CSED Extension* (June 21, 2012).

11 SB/SE, *CSED Database Version 2.5* (Mar. 29, 2011).

12 TAS-SB/SE CSED Workgroup, *Memorandum re: CSED Research Project Deliverables* (July 12, 2012).

13 IRS, Training 43982-101, *Collection Statute Expiration Date (CSED) – Verification and Correction Instructor's Guide* xii-xiv (Apr. 2012). The Filing and Payment Compliance function includes the Automated Collection System (ACS), Compliance Service Collection Operations (CSCO), ACS Support (ACSS) Operations and the W&I and SB/SE Field Compliance Services Sites. IRM 1.4.20 (Jan. 20, 2012).

14 IRS, Training 43982-101, *Collection Statute Expiration Date (CSED) – Verification and Correction Instructor's Guide* A-4-3 (Apr. 2012).

15 *Id.* at C-3-3, C-4-3.

16 IRS response to TAS information request (Sept. 17, 2012).

17 *Id.*

18 *See* http://mysbse.web.irs.gov/mgrsact/eq/default.aspx (last visited July 10, 2012).

review cases to "identify if the employee addressed statute issues (Assessment Statute Expiration Date /CSED) and followed statute procedures."[19]

In April 2012, the EQ job aid omitted this attribute, and thus may have unintentionally de-emphasized quality review of CSED issues for frontline employees.[20] However, as part of a comprehensive review of all EQ attributes, the IRS determined that Attribute 611 was used infrequently by managers, because they often chose to review CSEDs through ENTITY, which is a case management information system that can report whether employees have reviewed CSEDs on an account.[21] Even if ENTITY review shows that employees reviewed CSEDs, such a review does not guarantee that the CSEDs were correctly calculated. Thus, the National Taxpayer Advocate remains concerned that the IRS may not be using a consistent approach to training and reviewing employees who verify and correct CSEDs. The IRS needs a centralized office to promote consistency and preserve standards across units.

TAS's Research of CSED Issues Has Revealed Additional Problems for Taxpayers Who Have Multiple Assessments for the Same Tax Year or Module.

TAS has continued to research CSED problems and has found the IRS does not adjust account modules with multiple assessments and CSEDs when the CSED expires for the earlier assessment.[22] For example, an account module for one tax year may contain multiple entries assessing liability for tax, including assessments made when the taxpayer files a return, or when the IRS makes an audit adjustment a year or so later. Because the IRS's Integrated Data Retrieval System (IDRS) cannot associate accruals, payments, or credits to a particular assessment, employees must manually calculate the CSED and adjust account modules that have multiple assessments. In many cases, the IRS does not adjust accounts upon the earlier CSED expiration, which may cause unlawful additional accruals, continuing collection actions, overstatement of accounts receivable, and posting of refund offsets to satisfy expired assessments.[23]

On advice from TAS, W&I created a specialized Multiple CSED (MULTICSED) unit at the Kansas City Campus to develop a process to verify CSEDs and correct all taxpayer account modules with multiple CSEDs from the 1960s forward. The unit will adjust expired balances, post accruals, and issue refunds on non-statute barred credits. From February 23, 2012, through March 23, 2012, the MULTICSED unit reviewed and adjusted 77 tax modules, writing off over $84,000.[24] The unit will also develop a MULTICSED transcript for

19 IRS, Document 12359, *Field Compliance Embedded Quality, Field Collection, Collection Field Function (CFf) Job Aid* (May 2011). Attribute 611 was intended to assist managers only and was not intended to aid in the national quality review for the CFf.

20 IRS, Document 12359, *Field Compliance Embedded Quality, Field Collection (FC) Job Aid* (Apr. 2012).

21 IRS response to TAS information request (Sept. 17, 2012). The IRS noted that Attribute 611 was used in only 18.8 percent of cases reviewed in 2011, because managers chose instead to review the CSEDs through ENTITY to avoid duplicating work.

22 TAS, Systemic Advocacy Management System (SAMS) Project #10935, Executive Summary, CSEDs are Incorrect on Modules with Multiple Assessment Dates 5 (Apr. 5, 2012).

23 *Id.* at 3-5.

24 IRS response to TAS information request (Sept. 17, 2012). The unit did not issue any refunds or write off any credits barred for refund under IRC § 6511.

employees to use when resolving accounts with multiple assessments. The scheduled release date for the transcript is January 2013.[25] In the interim, W&I issued guidance to accept TAS Operations Assistance Requests (OARs) to resolve MULTICSED account problems.[26] The National Taxpayer Advocate commends W&I for its efforts to correct these accounts.

Improved Tools and Systems Will Help the IRS Identify and Correct CSEDs.

CSED calculations involve adjustments incident to extensions agreed to by taxpayers or statutory provisions suspending CSEDs (*e.g.*, collection due process hearings, OIC processing, or bankruptcy).[27] The calculations are further complicated because the IRS accounted for joint filers on one account per tax module until 2002. The IRS has since developed a way to split spousal accounts when CSED adjustments affect only one spouse (*e.g.*, one spouse filing bankruptcy and Tax Court petitions, one spouse submitted an offer in compromise, etc.).[28] Through the advocacy of the National Taxpayer Advocate and TAS, the IRS has developed several approaches to these problems, described below.

The IRS established a cross-functional team, including TAS, to create a CSED correction tool. The CSED Calculator Project had its initial meeting in late August 2010 to develop a spreadsheet-based calculator to help employees determine correct CSEDs on accounts.[29] The team developed a CSED calculator (CCalc), which was released to employees in September 2012.[30]

Moreover, the National Taxpayer Advocate is pleased by the progress of the new Customer Account Data Engine 2 (CADE 2) database in resolving some of the issues regarding split spousal accounts. CADE 2 will associate taxpayer obligations with specific individuals, which will break the previous joint spousal model and should relieve some of the burden on taxpayers caused by divorce or separation of spousal associations in prior filings affecting CSEDs.[31]

The IRS anticipates that the next stage of CADE 2 implementation, if appropriately funded, will systemically resolve most CSED problems by January 2014.[32] The National Taxpayer Advocate will continue to advocate for taxpayers who need CSED corrections and resolution of other CSED issues until the IRS improves its new tools and systems. Further, the

25 IRM 5.19.10.4.7 (Oct. 15, 2012).

26 IRM 5.19.10.4 (Oct. 15, 2012).

27 IRC § 6330(e); IRC § 6331(k)(3); IRC § 6503(h).

28 National Taxpayer Advocate 2009 Annual Report to Congress 273.

29 SB/SE, CSED Calculator (CCalc) – MS Excel Based Project Definition Form (approved Aug. 20, 2010).

30 *See* http://mysbse.web.irs.gov/Collection/toolsprocesses/csedcalculator/default.aspx (last visited Sept. 26, 2012).

31 CADE 2 Program Management Office response to TAS information request (Aug. 31, 2010).

32 IRS response to TAS information request (Sept. 17, 2012). The CADE 2 Program Management Office is working with SB/SE on a proposal to change the method of applying payments on accounts with CSED issues. CADE 2 Program Management Office response to TAS information request (Aug. 31, 2010). *See* http://it.web.irs.gov/CADE2/ (last visited July 11, 2012).

National Taxpayer Advocate believes the IRS needs a central oversight office to oversee the CSED calculator and the CADE 2 CSED implementation to correct CSEDs once and for all.

CONCLUSION

The National Taxpayer Advocate is pleased with the IRS's progress in developing tools, training, and systems to resolve CSED issues. However, the IRS operating divisions' piecemeal approach may not be uniform or consistent, due to a lack of centralized oversight of CSED treatment and training.

The National Taxpayer Advocate recommends that the IRS take the following actions:

1. Coordinate its CSED training and case reviews to reinforce and reward the verification and correction of CSEDs.
2. Organize a centralized CSED office to refine training, create and maintain CSED tools, and oversee programs such as the MULTICSED unit.

Status Update: The Combined Annual Wage Reporting Program Continues to Impose a Burden on Employers Despite IRS Improvements

RESPONSIBLE OFFICIAL

Faris Fink, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The IRS and the Social Security Administration (SSA) jointly administer the Combined Annual Wage Reporting (CAWR) program, which compares employer data reported to the IRS with the employer/employee data reported to SSA to ensure accurate reporting of taxpayers' wages. Employers file Form 941, *Employer's Quarterly Tax Return* with the IRS, and file Form W-2, *Wage and Tax Statement* for each employee with SSA. Ideally, all information reported on Forms 941 should match the information on Forms W-2 for all employees in a given year. In practice, however, that is not always the case. The IRS and SSA both use a reconciliation process to ensure employers filed the correct W-2s timely and withheld and paid the proper amount of tax.

In prior Annual Reports to Congress, the National Taxpayer Advocate raised concerns about problems employers encountered with the IRS's reconciliation process.[1] The IRS has significantly improved the CAWR program by:

- Adjusting its workload to better align with resources;
- Improving inventory management and case selection;
- Issuing interim letters to taxpayers with updates on their cases; and
- Providing copies of CAWR notices to authorized third parties.

While these changes have reduced problems, the IRS should continue improving CAWR procedures by exploring the causes for and resolving these issues:

- The IRS's untimely responses to employers' correspondence cause unnecessary assessment and subsequent abatement of penalties.
- The low employer response rate to CAWR notices leads to rework for the IRS.
- The assessment of penalties by the IRS may not improve employers' reporting compliance.

[1] National Taxpayer Advocate 2003 Annual Report to Congress 220 (Most Serious Problem: *Combined Annual Wage Reporting (CAWR) Reconciliation*); National Taxpayer Advocate 2008 Annual Report to Congress 316 (Most Serious Problem: *Inefficiencies in the Administration of the Combined Annual Wage Reporting (CAWR) Program Impose Substantial Burden on Employers and Waste IRS Resource*); National Taxpayer Advocate 2010 Annual Report to Congress 291 (Most Serious Problem: *The Combined Annual Wage Reporting Program Continues to Impose a Substantial Burden on Employers*).

ANALYSIS OF PROBLEM

Background

In the 1970s, Congress grew increasingly concerned about the burden the wage and tax reporting system placed on employers, especially small businesses. Before tax year 1978, employers filed Form 941 to report wages in the aggregate for all employees, and also filed Form 941-A, listing employees by name, Social Security number and the amount of wages paid to each employee in that quarter. After processing the returns, the IRS sent the Forms 941-A to SSA for posting to individual employees' wage records.

In 1976, Congress enacted legislation to address the reporting and filing burden for employers.[2] The new provision authorized the IRS and SSA to enter into an agreement to process wage and tax information starting with tax year 1978. Under CAWR, employers no longer reported wages earned by individual employees quarterly, but only reported the aggregate total of wages paid to all employees. This change may have reduced the filing burden for employers, but it increased the potential for discrepancies. Under CAWR, employers submit wage and tax data to the IRS and SSA in different formats and at different times during the year.

Currently, employers must file employment tax returns *i.e.,* Forms 941, *Employer's Quarterly Federal Tax Return,* with the IRS.[3] Employers also file Forms W-2 and Form W-3, *Transmittal of Wage and Tax Statements* with SSA. The IRS and SSA have their own systems for reconciling discrepancies in wages reported.[4] When more wages are reported to SSA than to the IRS, the IRS examines the discrepancy as an IRS-CAWR case to determine if the employer underpaid Social Security tax and additional tax is due. However, an employer's failure to file correct Forms W-2 timely can adversely affect an employee's eligibility for SSA benefits. In an SSA-CAWR case, SSA matches Form 941 data with Forms W-2 and W-3 and notifies the employer of missing or incorrect W-2 forms. If the employer does not respond, SSA refers the case to IRS for enforcement action.[5]

In either an IRS-CAWR or SSA-CAWR case, the IRS attempts to reconcile the discrepancy by sending notices to the employer requesting additional information to clarify wages paid and taxes withheld. The IRS can penalize employers that do not respond and also can assess penalties if employers fail to file information returns such as Forms W-2 or file them

2 Pub. L. No. 94-202, § 8, 89 Stat. 1137, (1976).

3 Employment tax returns include Form 941 (*Employer's Quarterly Federal Tax Return*), Form 943 (*Employer's Annual Tax Return for Agricultural Employees*), and Form 944 (*Employer's Annual Federal Tax Return*). Taxpayers also file Form 945 (*Annual Return of Withheld Federal Income Tax*), Schedules H (*Household Employment Taxes*) with Forms 1040 (*U.S. Individual Income Tax Return*) or 1041 (*U.S. Income Tax Return for Estates and Trusts*).

4 Agreement between the SSA and IRS (2007).

5 The IRS reconciliation process takes place two to three years behind the current year. For example, in 2012, the IRS is examining IRS-CAWR cases for tax year 2010 and SSA-CAWR cases for tax year 2009. An IRS-CAWR case involves underpayment of taxes, excess withholding tax, or Advanced Earned Income Tax Credit (AEITC), which Congress repealed for years after tax year 2010. An SSA-CAWR case is generated when an employer does not file proper wage and tax statements (Forms W-2).

after the due date.[6] Recent legislation has increased the penalties under Internal Revenue Code (IRC) § 6721(a) from $50 to $100, beginning with tax year 2011, for each information return an employer fails to file timely and correctly.[7] IRC § 6721(e) provides for a harsher penalty if an employer intentionally disregards filing requirements. The Treasury Regulations define "intentional disregard" as knowing or willful conduct.[8] Whether a person knowingly or willfully fails to file timely or fails to include correct information is determined based on all the known facts and circumstances in the particular case.

The IRS Took Steps to Improve the CAWR Program but Needs to Address Ongoing Delays.

As of May 2010, the IRS failed to work almost 87 percent of all CAWR correspondence timely.[9] The IRS has since implemented improvements in the program that reduced its overaged correspondence rate to 25.6 percent.[10] The figures below show the inventory and the percentage of overage CAWR cases at the end of fiscal years (FY) 2010, 2011, and 2012.[11]

6 IRM 4.19.4.3.1 (Apr. 3, 2012).

7 Small Business Jobs Act of 2010, Pub. L. No. 111-240, § 2102, 124 Stat. 2504 (2010). The effect of the change in the amount of the penalty will not be known until 2014, when IRS reconciles 2011 wage and tax data.

8 Treas. Reg. § 301.6721-1(f)(2) (2010).

9 National Taxpayer Advocate 2010 Annual Report to Congress 291 (Most Serious Problem: *The Combined Annual Wage Reporting Program Continues to Impose a Substantial Burden on Employers*).

10 Small Business/Self-Employed Division (SB/SE) response to TAS information request (Oct. 15, 2012).

11 Inventory is considered overage after 90 days from the IRS-received date of taxpayer correspondence. SB/SE response to TAS information request (Dec.5, 2012).

FIGURE 1.S6.1, Inventory and Overage CAWR Cases[12]

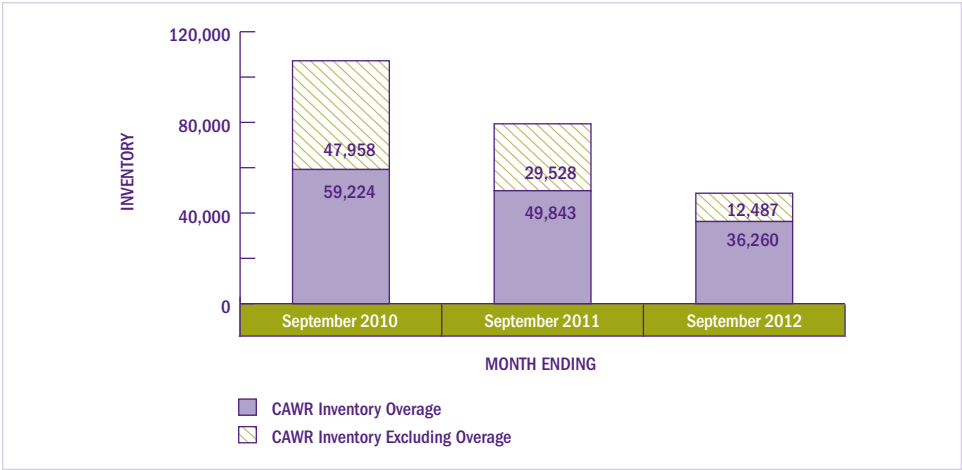
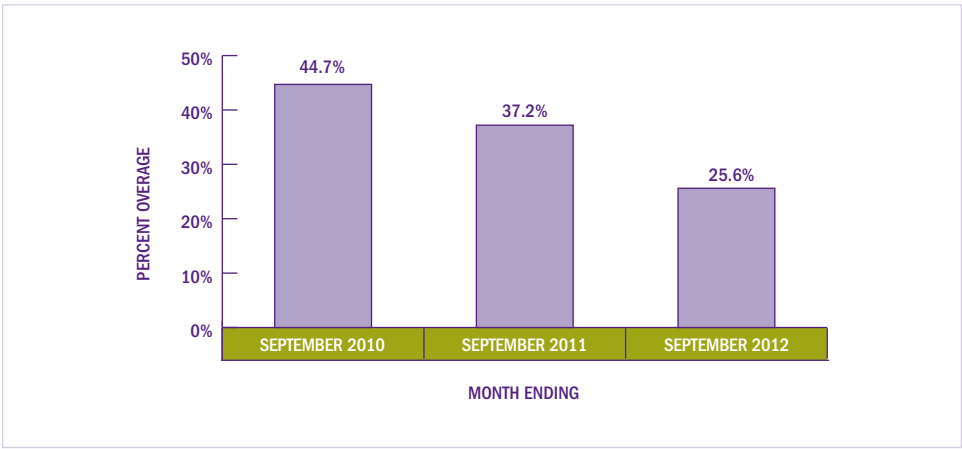


FIGURE 1.S6.1, Percent of Overage CAWR Cases[13]



As part of the effort to improve the program and reduce overage cases, in 2012 the IRS completed its consolidation of the program from three to two campuses located in Memphis and Philadelphia[14], but staffing decreased by 28 percent over FY 2010 levels.[15] In contrast, the volume of correspondence continues to increase.[16] While the IRS uses reports

12 SB/SE response to TAS information request (Oct.15, 2012).

13 *Id.*

14 Servicewide Electronic Research Program (SERP) Alert 12A0394, CAWR IRM 4.19.4 and FUTA 4.19.5 Case Routing Changes (June 18, 2012). The consolidation of the CAWR program started in Nov. 2010, *available at* http://mysbse.web.irs.gov/Collection/toolsprocesses/CaseRes/adj/send/cf/JobAids/18009.aspx (last visited Dec. 5, 2012).

15 Total staffing in the CAWR Unit in FY 2010 was 164 employees and in FY 2012 136 employees. SB/SE response to TAS information request (Oct. 5, 2012).

16 SB/SE response to TAS information request (Sept. 26, 2012).

to monitor inventory and address further aging of cases, factors such as the decrease in staffing, increased workloads, and competing priorities continue to contribute to the delays in resolving overage CAWR cases.[17]

The Low Response Rate to CAWR Notices Leads to Rework for the IRS.

In FY 2012, the IRS closed 52 percent of CAWR cases because it did not receive responses from employers.[18] In these cases, the IRS assesses the proposed tax and penalty and begins collection efforts, at which point employers may request abatement of the assessment. All of these events cause rework for the IRS. The table below shows the number of responses in CAWR cases closed in a fiscal year.

FIGURE 1.S6.3, Response to CAWR Notices[19]

Fiscal Year	Closure Notices	Replies	Late Replies[20]	No Replies	Undeliverable Notices
2010	289,244	40,447	5,376	156,617	15,537
2011	204,287	23,844	6,206	129,579	14,666
2012	266,801	60,816	10,977	139,204	5,929

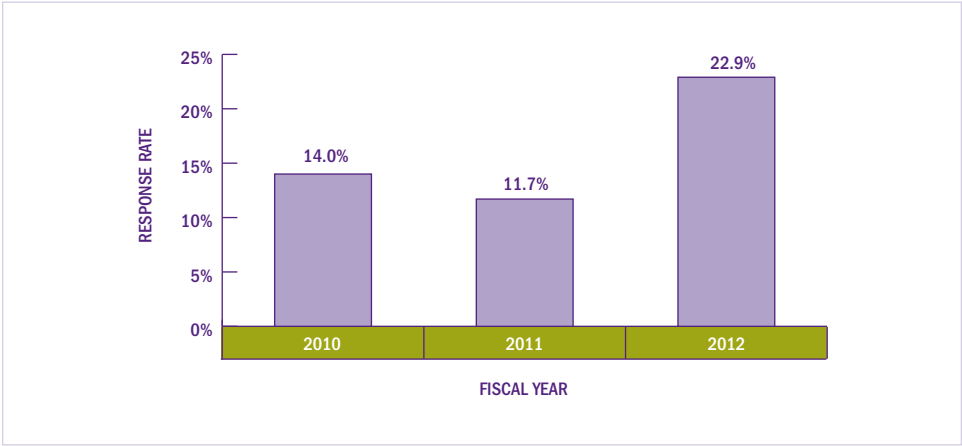
17 IRM 4.19.4.10.1 (Apr. 3, 2012) describes the CAWR Tax Examiner's responsibilities and priorities.

18 SB/SE response to TAS information request (Oct. 5, 2012). The response rate is the number of timely replies divided by the number of closure notices.

19 SB/SE responses to TAS information requests (Sept. 26, 2012 and Oct. 5, 2012). The figure includes data about the notices IRS sends in IRS-CAWR and SSA-CAWR cases.

20 Late replies are cases in which the employer's response is received by the IRS after the initial case is closed on the CAWR Automated Program (CAP system). IRM 4.19.4.6 (Apr. 1, 2010). The late replies listed in the figure represent notices issued for specific tax years worked during each fiscal year.

FIGURE 1.S6.4, Response Rate to CAWR Notices[21]



As shown above, the response rate almost doubled and the number of employer replies for FY 2012 increased by 155 percent compared to FY 2011. Additionally, the number of undeliverable notices declined by 60 percent during that time.[22] The IRS revised CAWR notices to provide more detailed wage and tax information to help employers reconcile discrepancies and began sending notices to authorized third parties, which may explain the increase in employer replies. Although the IRS has improved its communications to employers, the IRS should research and study potential reasons behind the low response rate and develop approaches to address the problem, including establishing toll-free phone lines in CAWR operations or allowing employers to establish alternate business addresses for employment tax matters.[23]

The IRS Should Establish a Toll-Free Number for CAWR Units.

CAWR notices generally do not include a telephone number for direct access to the CAWR unit, but instead list a toll-free number answered by an automated system. The employer may reach a live assistor at the general IRS toll-free number who has no access to the CAWR discrepancy data and will simply advise the taxpayer to respond immediately by mail or fax.[24] The National Taxpayer Advocate recommended the IRS include a toll-free number for the CAWR units so employers can reach the employee working the actual case or at least with access to CAWR data. The IRS did not agree with the specific recommendation, but did commit to explore whether this idea was practical. In 2011, SB/SE asked

21 SB/SE responses to TAS information requests (Sept. 26, 2012 and Oct. 5, 2012). The figure includes data about the notices the IRS sends in IRS-CAWR and SSA-CAWR cases.

22 *Id.*

23 Many employers have separate offices handling income tax matters and employment tax/payroll matters. They have suggested to the National Taxpayer Advocate that the IRS allow them to designate a separate address for employment tax correspondence, to eliminate routing delays and losses. Conversations between Information Reporting Program Advisory Committee (IRPAC) and the National Taxpayer Advocate, 2011 and 2012.

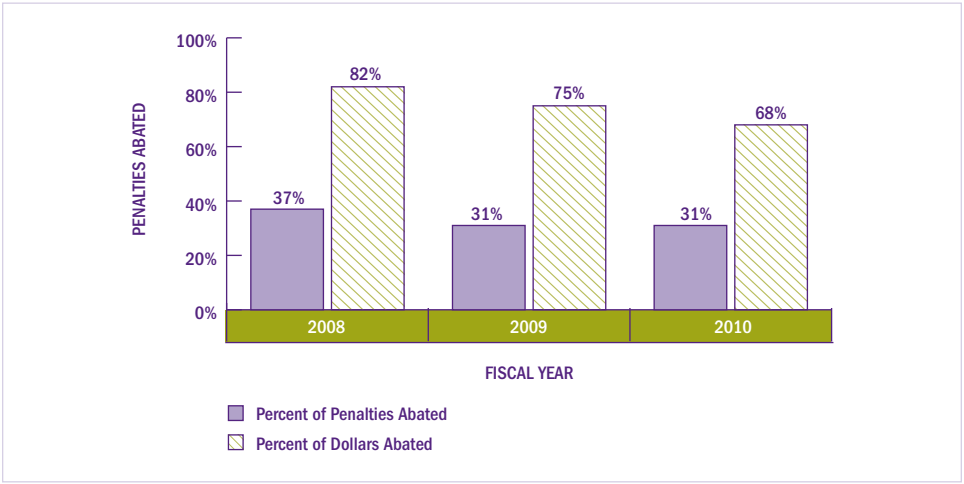
24 IRM 4.19.4.11 (Feb. 1, 2008).

for funding to establish a toll-free number in the CAWR units in 2013.[25] As SB/SE noted in the request, by the time the IRS receives the employer's correspondence, the case often has advanced to the next phase of assessment, which contributes to reconsideration cases and has led the National Taxpayer Advocate to list CAWR as a Most Serious Problem in her last two Annual Reports.[26] We applaud SB/SE for initiating this request and urge the IRS to move forward with implementation. Providing employers direct access to the CAWR operation would help to resolve cases, reduce correspondence backlogs, and vastly improve customer satisfaction.[27]

The Decline in Penalty Abatements Warrants Further Study.

As the figure below shows, the percentages of penalty dollars and number of penalties abated in CAWR cases under IRC § 6721 (a) and (e) are declining. [28]

FIGURE 1.S6.5, Percentage of CAWR Penalty Abatements[29]



25 SB/SE FY 2013 Initiative Business Case Justification CAWR FUTA Toll-Free Telephones (Jan. 2011).

26 SB/SE considers late replies from taxpayers as reconsideration cases because they have already been closed and the IRS reopens it to consider the taxpayer's information to resolve the wage and tax discrepancy. See IRM 4.19.4.6 (Apr. 1, 2010).

27 SB/SE FY 2013 Initiative Business Case Justification CAWR FUTA Toll-Free Telephones (Jan. 2011).

28 IRS Enforcement Revenue Information System (ERIS), IRC § 6721, Penalty Data on Failure to File Information Return and Intentional Disregard Penalties from the Compliance Data Warehouse.

29 IRS Enforcement Revenue Information System (ERIS), IRC § 6721(a) and (e), Penalty Data on Failure to File Information Return and Intentional Disregard Penalties from the Compliance Data Warehouse. ERIS captures data on civil monetary penalties.

The IRS attributes the declines in abatement of penalty dollars and the number of penalties to clarified guidance, employee training, outreach, and education to employers. While this may be correct, the IRS has not gathered data to support its position. Moreover, the IRS has not determined the effect of the penalty on voluntary compliance. While the decline may suggest the penalties assessed are justified, the IRS cannot validate this assumption. The IRS maintains that penalties are meant to encourage compliance by increasing the cost of noncompliance.[30] In a final report issued in 2012, SB/SE Research stated that due to limited data, it cannot draw any conclusion about the long-term effects of penalties, and recommended further analysis when more data is available.[31] However, SB/SE indicated it has no plans to continue the research.[32] The National Taxpayer Advocate believes further analysis of the decline in penalty abatement and of the penalty's impact on compliance is warranted, and urges the IRS to continue its research.

CAWR Improvements Scheduled for FY 2014

The IRS plans to launch a redesigned CAWR system in FY 2014 as part of the Information Reporting Document Matching (IRDM) effort.[33] The new system is expected to upgrade automation and technology to support data-driven CAWR case creation and selection, better case management at the individual employer level, interest calculation capabilities, and various other inventory tracking and report functions. The National Taxpayer Advocate supports the IRS efforts to create a new CAWR system.

The National Taxpayer Advocate recommended the IRS redesign CAWR notices to include specific information to help employers comply or allow them more time to respond. The IRS has revised the notices to provide more detailed wage and tax information to help employers reconcile discrepancies, and has created a new notice to match non-payroll payments reported on Form 945, *Annual Return of Withheld Federal Income Tax*.[34] The new notices will be part of the launch of the new CAWR system in FY 2014.

30 IRS Penalty Policy Statement 20-1, IRM 1.2.20.1.1(3)2 (June 29, 2004).

31 SB/SE Research Philadelphia, *Penalty Assessments on Information Returns*, Project ID: PHIL0164 (Feb. 2012).

32 SB/SE response to TAS information request (Sept. 28, 2012).

33 See Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights is Critical as the IRS Develops a Real-Time Tax System*, *supra*.

34 SB/SE response to TAS information request (Sept. 28, 2012). Non-payroll payments include: pensions (including distributions from tax-favored retirement plans and annuities, military retirement, gambling winnings, Native American gaming profits, voluntary withholding on certain government payments, and backup withholding reported on Form 1099-R, *Distribution from Pensions*, Form 1099-MISC, *Miscellaneous Income*, and Form W-2G, *Certain Gambling Winnings*.

CONCLUSION

Since 2010, the IRS has taken significant steps to improve the CAWR program and plans further improvements in FY 2014. The IRS should continue to evaluate the CAWR program's effectiveness and implement improvements. The National Taxpayer Advocate recommends that the IRS:

- Evaluate the late-response and no-response cases to determine if the current timeframe for employer response is reasonable and whether response would improve if employers could designate a dedicated address for employment tax notices.
- Study the reasons for the low employer response to CAWR notices and develop approaches to improve that rate.
- Continue research to determine whether the assessment of Failure to Timely File Information Returns penalty and the Intentional Disregard penalty increase employer compliance.
- Establish a toll-free operation dedicated to the CAWR units.
- Launch a redesigned and improved CAWR Program as part of the IRDM in FY 2014, as planned.

Introduction: Legislative Recommendations

Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The chart immediately following this Introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2011 Annual Reports.[1] The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion details recent developments relating to the National Taxpayer Advocate's proposals.

Taxpayer Bill of Rights

In last year's Annual Report to Congress, the National Taxpayer Advocate recommended that Congress enact the legislative recommendations detailed in previous reports, beginning with her 2007 recommendation to codify a taxpayer bill of rights that would explicitly detail the rights and responsibilities of taxpayers.[2] On June 28, 2012, Senator Bingaman and Congressman Becerra introduced companion bills entitled the Taxpayer Bill of Rights Act of 2012 (TBOR 2012).[3] This legislation would codify a taxpayer bill of rights by amending the Internal Revenue Code (Code) to require the IRS, in consultation with the National Taxpayer Advocate, to publish a summary statement of the rights and obligations of taxpayers under the Code.[4] The legislation would also codify the National Taxpayer Advocate's authority to issue a Taxpayer Advocate Directive to the IRS.[5]

TBOR 2012 contains many of the National Taxpayer Advocate's proposals. The National Taxpayer Advocate recommended that the IRS create an effective oversight and penalty

1 An electronic version of the chart is available on the TAS website at www.TaxpayerAdvocate.irs.gov.

2 National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*).

3 S. 3355, 112th Cong. (2012); H.R. 6050 112th Cong. (2012).

4 The bill lists the following rights to be included: to be informed, to be assisted, to be heard, to pay no more than the correct amount of tax, to appeal, to certainty, to privacy, to confidentiality, to appoint a representative, and to a fair and just tax system. The bill lists five obligations: to be honest, to be cooperative, to provide accurate information and documents on time, to keep records, and to pay taxes on time. S. 3355, 112th Cong. § 101 (2012).

5 S. 3355, 112th Cong. § 306 (2012). *See* National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*). Taxpayer Advocate Directives mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers or all taxpayers. IRM 13.1.4.2.2.5 (Oct. 31, 2004).

regime for return preparers;[6] TBOR 2012 requires the IRS to regulate any preparers not already regulated, creates a penalty for unauthorized preparation of returns, and expands and increases current preparer penalties.[7] The legislation also includes registration and disclosure requirements and new penalties for persons facilitating refund delivery products.[8]

The National Taxpayer Advocate has advocated for numerous changes to the IRS's filing and reporting of federal tax liens.[9] Under TBOR 2012, the IRS would have to weigh the benefit to the government and the harm to the taxpayer before filing a lien and would have to provide the taxpayer with an opportunity to appeal the lien determination before the lien is filed.[10] Additionally, TBOR 2012 would amend the Fair Credit Reporting Act to require removal of derogatory lien-filing information from credit reports under certain circumstances.[11]

TBOR 2012 contains the National Taxpayer Advocate's recommendation to provide statutory authority for IRS employees to refer taxpayers to a specific low income taxpayer clinic (LITC) for assistance.[12] In addition, TBOR 12 requires the Department of Treasury to study the accelerated processing of information returns and the effectiveness of collection alternatives.[13] The legislation also includes the National Taxpayer Advocate's 2011 recommendation to clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.[14]

SMALL BUSINESS TAXPAYER BILL OF RIGHTS ACT OF 2012

Senator John Cornyn and Congressman Sam Johnson introduced legislation that would enact a number of the National Taxpayer Advocate's previous recommendations.[15] The legislation would prohibit *ex parte* communications between Appeals officers and other IRS

6 *See, e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*), National Taxpayer Advocate 2008 Annual Report to Congress 423-26 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*).

7 S. 3355, 112th Cong. §§ 202, 204 (2012). The bill increases the preparer penalty for gross misconduct to 100 percent of the amount of the understatement of tax. *Id*.

8 S. 3355, 112th Cong. § 203 (2012).

9 *See, e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 357-64 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*).

10 S. 3355, 112th Cong. § 301 (2012).

11 S. 3355, 112th Cong. § 302 (2012).

12 S. 3355, 112th Cong. § 201 (2012). *See* National Taxpayer Advocate 2007 Annual Report to Congress 551-52 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

13 S. 3355, 112th Cong. § 309 (2012). The National Taxpayer Advocate has recommended both of these studies. *See* National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*), vol. 2, 19-34 (Research Study: *Subsequent Compliance Behavior of Delinquent Taxpayers: A Compliance Challenge Facing the IRS*).

14 S. 3355, 112th Cong. § 310 (2012). *See* National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*). The term "de novo" means anew. *Black's Law Dictionary* (9th ed. 2009).

15 Small Business Taxpayer Bill of Rights Act of 2012, S. 2291, 112th Cong. (2012); H.R. 4375, 112th Cong. (2012).

employees.[16] The bill includes two recommendations relating to collection. The legislation would extend the period in which a third party can bring a suit for return of levied funds or proceeds,[17] and waive the installment agreement fee for taxpayers whose adjusted gross income does not exceed 250 percent of the federal poverty level.[18]

The legislation contains two of the National Taxpayer Advocate's recommendations regarding relief from joint and several liability. The bill would allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.[19] The legislation would also clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.[20]

RELEASE LEVIES CAUSING ECONOMIC HARDSHIP TO BUSINESSES

The National Taxpayer Advocate has advocated for many reforms to the IRS's levy program. Most recently, she recommended that Congress amend the Code to allow the IRS to release levies on business taxpayers that impose economic hardship.[21] This year, Congressman McDermott introduced legislation that would allow the IRS to release a levy if the levy was causing economic harm to the taxpayer's trade or business.[22]

EXTEND THE DUE DATE FOR S CORPORATION ELECTION

The National Taxpayer Advocate has called attention to the harmful consequences of allowing taxpayers to elect S corporation status only if they do so by the 15th day of the third month of their financial year.[23] Senator Franken introduced legislation to allow corporations to elect S corporation status with their first filed returns.[24]

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16 S. 2291, 112th Cong. § 7 (2012). *See* National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*) (noting the IRS Restructuring and Reform Act of 1998 prohibits ex parte communication between Appeals employees and other IRS employees, but recent IRS practices allowing Appeals employees to share office space with other IRS employees foster a perception of a lack of independence).

17 The bill extends the time for third parties to bring suit from nine months to three years. H.R. 4375, 112th Cong. § 9 (2012). *See* National Taxpayer Advocate 2001 Annual Report to Congress 202-09 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

18 S. 2291, 112th Cong. § 10 (2012). *See* National Taxpayer Advocate 2006 Annual Report to Congress 141-56 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*) (recommending the IRS implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required).

19 S. 2291, 112th Cong. § 11 (2012). *See* National Taxpayer Advocate 2004 Annual Report to Congress 490-92 (Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

20 S. 2291, 112th Cong. § 14 (2012). *See* National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*).

21 *See* National Taxpayer Advocate 2011 Annual Report to Congress 537-43 (Legislative Recommendation: *Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers that Impose Economic Hardship*).

22 H.R. 4368, 112th Cong. (2012).

23 *See, e.g.,* National Taxpayer Advocate 2010 Annual Report to Congress 410-11 (Legislative Recommendation: *Extend the Due Date for S Corporation Elections to Reduce the High Rate of Untimely Elections*).

24 S. 2271, 112th Cong. (2012).

RESTRICT ACCESS TO THE DEATH MASTER FILE

As one means to stem the growing number of tax related identity theft cases, the National Taxpayer Advocate recommended that Congress restrict access to the Social Security Administration's death master file (DMF).[25] Senator Nelson and Congressman Nugent introduced separate identity theft bills that that would limit access to the DMF records of individuals who died during the previous two calendar years.[26]

CONSOLIDATE EDUCATION INCENTIVES

The National Taxpayer Advocate has suggested consolidating and simplifying various provisions in the Code to make compliance less difficult for taxpayers.[27] Senator Schumer and Congressman Israel introduced companion bills that include the National Taxpayer Advocate's recommendation to consolidate the education tax credits known as the Hope Scholarship and the Lifetime Learning Credits.[28]

SUMMARY OF 2012 LEGISLATIVE RECOMMENDATIONS

We continue to advocate for the proposals we have made previously. In this report, we highlight some of the recommendations in prior reports that will protect taxpayer rights. In addition, we present seven new legislative recommendations, summarized below. The first three recommendations concern family status issues, which are part of fundamental tax reform.[29] The remaining four involve issues of taxpayer rights.

FAMILY STATUS LEGISLATIVE RECOMMENDATIONS

1. Simplify the National Status and Related Requirements for Qualifying Children. Confusion arises when similar taxpayers receive different deductions or credits depending on the residence or national status of their children. The dependency deduction, child tax credit (CTC), and Earned Income Tax Credit (EITC), all of which relate to the cost of raising children, have different requirements in terms of where the child must reside, whether the child is an American citizen or national, and whether the child has a social security number. Due to the inconsistency of these requirements, similarly situated taxpayers may fail to claim the correct benefits.

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25 *See* National Taxpayer Advocate 2011 Annual Report to Congress 519-23 (Legislative Recommendation: *Restrict Access to the Death Master File*). The death master file is a database available to the public that includes the full name, SSN, date of birth, date of death, and the county, state, and Zip code of the last address on record of decedents. *Id*.

26 S.1534, 112th Cong. § 9 (2012); H.R. 6205, 112th Cong. § 7 (2012). Both bills also include the National Taxpayer Advocate's administrative recommendation to allow victims of tax related identity theft to turn off the ability to file electronically. *See* National Taxpayer Advocate 2011 Annual Report to Congress 48, 63 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*).

27 *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 370-72 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*).

28 S. 3267, 112th Cong. (2012); H.R. 6522, 112th Cong. (2012).

29 For a discussion of previous recommendations relating to fundamental tax reform, see National Taxpayer Advocate 2010 Annual Report to Congress 365-72 (Legislative Recommendation: *Enact Tax Reform Now*).

The National Taxpayer Advocate recommends that Congress simplify the three-part children's national status requirements in conformity with overall simplification of the family tax benefits as the National Taxpayer Advocate previously proposed. This includes:

- Consolidating the dependency deduction and CTC (nonrefundable portion) with head of household filing status into a Family Credit;
- Consolidating and modifying the EITC with the refundable portion of the CTC into a Worker Credit not contingent on qualifying children;
- Applying the contiguous country rule encompassing the U.S., Canada, and Mexico for the Family credit;
- Requiring an SSN valid for employment for the Worker Credit; and
- Repealing as obsolete the residence rule that requires the child to be a citizen, national, or otherwise in the U.S.

2. Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered "Not Married." Married taxpayers must file joint returns to claim important tax benefits such as the EITC. IRC § 7703, which determines marital status, permits some married taxpayers to be "considered as" not married. So long as these married taxpayers meet the other pertinent statutory requirements, they will be entitled to the tax benefits claimed on their separate returns. IRC § 7703(b), however, prevents taxpayers from being considered "not married" in two ways.

- First, the statute retains an outdated "cost of maintaining a household" test that disproportionately affects members of racial and ethnic minorities who work and have children.
- Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year's end.

The National Taxpayer Advocate recommends that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered "not married."

3. Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes. Between January 1, 2003, and December 31, 2012, a taxpayer adopting a child who has been determined by a state to have special needs could claim an adoption tax credit of $10,000, plus an inflation adjustment, even if the adoptive parent paid no actual qualified adoption expenses in connection with the adoption. A "child with special needs" is defined as a child whom a state has determined cannot or should not be returned to the home of his parents, and the state has also determined has a specific factor or condition making it reasonable to conclude that placement of the child with adoptive parents requires adoption assistance. Under the IRC, however, a Native American tribal government is treated as a state only

if (a) a particular Code section specifically so provides, or (b) the Code section is listed in § 7871. Neither § 23 nor § 7871 provides that a Native American tribal government can be treated as a state for purposes of the adoption credit. Thus, a determination by a Native American tribal government that a child is a special needs child would not entitle the adoptive parents to a special needs adoption credit. The National Taxpayer Advocate recommends that Congress amend IRC § 7871(a) to include IRC § 23 in the list of Code sections for which a Native American tribal government is treated as a "State." If a Native American tribal government is treated as a state for purposes of IRC § 23, its determination that a child has special needs would enable adoptive parents to claim the special needs adoption credit, provided that the other requirements of the Code are met.

TAXPAYER RIGHTS LEGISLATIVE RECOMMENDATIONS

4. Amend IRC § 7701 to Provide a Definition of "Last Known Address" and Require the IRS to Mail Duplicate Notices to Credible Alternate Addresses. The IRS informs taxpayers of important statutory rights by sending notices or letters through the United States Postal Service (USPS). For essential notices that advise taxpayers of fundamental rights, such as the statutory notice of deficiency, it does not search beyond its own databases for a taxpayer's correct address, even when it learns that that address is incorrect. Given the availability of technology and the centrality of "last known address" to fundamental rights that preserve the perception (and actuality) of fairness in our tax system, the small burden of requiring reliable database investigation is more than outweighed by taxpayers' and the government's interest in procedural fairness.[30] The National Taxpayer Advocate reiterates her recommendation that Congress amend IRC § 7701 to add a definition of "last known address" that incorporates case law and current regulations. She also reiterates her recommendation that Congress direct the Secretary of Treasury to develop procedures for checking third-party databases for credible, alternate addresses prior to sending notices that establish legal rights and require the IRS to mail the notice simultaneously to the last known address and a credible alternate address when the IRS learns its records do not contain a taxpayer's correct address.

5. Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences. After a taxpayer fails to pay any tax, the federal tax lien arises by operation of law. The IRS may generally commence an administrative seizure when it notifies a taxpayer of the opportunity to be heard in a Collection Due Process (CDP) hearing. After the taxpayer's hearing (or failure to respond), the IRS may seize the taxpayer's property, subject to protections provided in the Code. However, after the IRS files a Notice of Federal Tax Lien (NFTL) in the public records and offers a CDP hearing to the taxpayer, the IRS may request that the U.S. Attorney General (AG) direct the filing of a suit to foreclose the tax lien and sell the taxpayer's principal residence, without reference to the protections

30 For information about the IRS's inadequate funding of its address systems, see Status Update: *Underfunding of IRS Initiatives to Modernize Its Taxpayer Address Systems Undermines Taxpayers' Statutory Rights and Impedes Efficient Resource Allocation, supra.*

applicable to seizures. The taking of principal residences without adequate taxpayer protections deprives taxpayers of their homes and the financial resources to acquire new ones.

The National Taxpayer Advocate recommends that Congress amend IRC § 7403 to preclude an IRS employee from requesting that the AG direct the filing of a civil action to foreclose the federal tax lien against a taxpayer's principal residence in U.S. District Court, unless the IRS employee has received executive level approval. This approval could only occur after determining that:

- The taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, including the expenses of the proceedings; and
- The foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer.

6. Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions. While some taxpayers may fraudulently convey their property to friends or relatives to avoid their personal legal obligation to pay taxes, others legitimately divest their property before the IRS assesses tax. The IRS files Notices of Federal Tax Lien (NFTLs) and issues levies against the property of third parties (individuals or entities, known as transferees, nominees, or alter egos) that hold property purportedly belonging to taxpayers subject to collection. However, these third parties are not considered taxpayers for the purposes of Collection Due Process (CDP) rights under IRC §§ 6320 and 6330 and therefore are not entitled to CDP rights. Without the protections afforded by IRC §§ 6320 and 6330, the third party against whom the IRS has taken a collection action has limited remedies, provided only after the collection action has occurred. These remedies are time-consuming, costly, and place an undue burden on those who cannot afford the significant expense of litigating in federal district court. The National Taxpayer Advocate recommends that Congress amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to "affected third parties," known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.

7. Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes. The payroll processing industry provides a valuable service to employers, especially small businesses, by helping them comply with complex federal, state, and local employment tax requirements. The industry has created various contractual arrangements with third party payers (TPPs) in which a TPP performs some or all of the employer's federal employment tax withholding, reporting, and payment obligations. While most TPPs are legitimate and trustworthy companies, a few "bad actors" have defrauded their clients and tarnished the image of the industry. Because the IRC does not protect taxpayers from TTP

failures and employers remain liable for payroll taxes, those victimized in these situations (especially self-employed and small business taxpayers) can experience significant burden.[31]

The National Taxpayer Advocate recommends that Congress amend the IRC to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees. Congress should amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause. The National Taxpayer Advocate further recommends that Congress amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.

31 For a further discussion of the harms caused by TPP failures, see Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*, *supra*.

National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82–100; National Taxpayer Advocate 2004 Annual Report to Congress 383–385; National Taxpayer Advocate 2008 Annual Report to Congress 356–362.	Repeal the AMT outright.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	HR 86	Bachmann	1/5/2011	Referred to Ways & Means Committee
	HR 99	Dreler	1/5/2011	Referred to Ways & Means Committee
	HR 547	Garrett	2/8/2011	Referred to Ways & Means Committee
	HR 3400	Garrett	11/10/2011	Referred to Ways & Means Committee
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 820	Shelby	4/14/2011	Referred to the Finance Committee
	HR 3804	Huelskamp	1/23/2012	Referred to Ways & Means Committee
Legislative Activity 111th Congress	S 3018	Wyden	2/23/2010	Referred to the Finance Committee
	HR 240	Garrett	1/7/2009	Referred to the Ways & Means Committee
	HR 782	Paul	1/28/2009	Referred to the Ways & Means Committee
	S 932	Shelby	4/30/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	S 55	Baucus	1/4/2007	Referred to the Finance Committee
	S 14	Kyl	4/17/2007	Referred to the Finance Committee
	S 1040	Shelby	3/29/2007	Referred to the Finance Committee
	HR 1365	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
	S 2293	Lott	11/1/2007	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464
Legislative Activity 109th Congress	HR 1186	English	3/9/2005	Referred to the Ways & Means Committee
	S 1103	Baucus	5/23/2005	Referred to the Finance Committee
	HR 2950	Neal	6/16/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 43	Collins	1/7/2003	Referred to the Ways & Means Committee
	HR 1233	English	3/12/2003	Referred to the Ways & Means Committee
	S 1040	Shelby	5/12/2003	Referred to the Finance Committee
	HR 3060	N. Smith	9/10/2003	Referred to the Ways & Means Committee
	HR 4131	Houghton	4/2/2004	Referred to the Ways & Means Committee
	HR 4164	Shuster	4/2/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 437	English	2/6/2001	Referred to the Ways & Means Committee
	S 616	Hutchison	3/26/2002	Referred to the Finance Committee
	HR 5166	Portman	7/18/2002	Referred to the Ways & Means Committee

Index AMT for Inflation National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	If full repeal of the individual AMT is not possible, it should be indexed for inflation.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3223	McConnell	9/13/2010	Placed on the Senate Calendar
	HR 5077	Hall	4/20/2010	Referred to the Ways & Means Committee
	HR 719	Lee	1/27//2009	Referred to the Ways & Means Committee
	S 722	Baucus	3/26/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	HR 703	Garrett	2/9/2005	Referred to the Ways & Means Committee
	HR 4096	Reynolds	10/20/2005	12/7/2005–Passed the House; 12/13/2005–Placed on the Senate Legislative Calendar
Legislative Activity 108th Congress	HR 22	Houghton	1/7/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/1/2002	Referred to the Ways & Means Committee
Eliminate Several Adjustments for Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 336	DeMint	2/14/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 102	Kerry	1/4/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1861	Harkin	10/7/2005	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 1939	Neal	5/12/2003	Referred to the Ways & Means Committee
Private Debt Collection (PDC)				
Repeal PDC Provisions National Taxpayer Advocate 2006 Annual Report to Congress 458–462.	Repeal IRC § 6306, thereby terminating the PDC initiative.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	HR 796	Lewis	2/3/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	S 335	Dorgan	1/18/2007	Referred to the Finance Committee
	HR 695	Van Hollen	1/24/2007	Referred to the Ways & Means Committee
	HR 3056	Rangel	7/17/2007	10/10/2007-Passed the House; 10/15/2007 Referred to the Finance Committee
Tax Preparation and Low Income Taxpayer Clinics (LITC)				
Matching Grants for LITC for Return Preparation National Taxpayer Advocate 2002 Annual Report to Congress vii–viii.	Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.			
Legislative Activity 111th Congress	Pub. L. No. 111-117, Div. C, Title I, 123 Stat. 3034, 3163 (2009).			
Legislative Activity 110th Congress	Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).			
	Bill Number	**Sponsor**	**Date**	**Status**
	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
	S 1967	Clinton	8/2/2007	Referred to the Finance Committee

Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	S 476	Grassley	2/27/2003	Referred to the Finance Committee
	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2001	Referred to the Ways & Means Committee
	HR 7	Baucus	7/16/2002	Reported by Chairman Baucus with an amendment; referred to the Finance Committee

Regulation of Income Tax Return Preparers

National Taxpayer Advocate 2002 Annual Report to Congress 216–230;
National Taxpayer Advocate 2003 Annual Report to Congress 270–301;
National Taxpayer Advocate 2007 Annual Report to Congress 83–95 & 140-155;
National Taxpayer Advocate 2008 Annual Report to Congress 423–426;
National Taxpayer Advocate 2009 Annual Report to Congress 41–69.

Create an effective oversight and penalty regime for return preparers by taking the following steps:

- Enact a registration, examination, certification, and enforcement program for federal tax return preparers;
- Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight;
- Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and
- Require the IRS to take steps within its existing administrative authority, including requiring a check-box on all returns in which preparers would enter their category of return preparer (*i.e.*, attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614

Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Referrals to LITCs National Taxpayer Advocate 2007 Annual Report to Congress 551–553.	Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 1573	Durbin	9/15/2011	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 171
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Public Awareness Campaign on Registration Requirements National Taxpayer Advocate 2002 Annual Report to Congress 216–230.	Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Increase Preparer Penalties National Taxpayer Advocate 2003 Annual Report to Congress 270–301.	Strengthen oversight of all preparers by enhancing due diligence and signature requirements, increasing the dollar amount of preparer penalties, and assessing and collecting those penalties, as appropriate.			
Legislative Activity 112th Congress	Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011).			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee

Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 4318	Crowley/ Ramstad	12/6/2007	Referred to the Ways & Means Committee
	S 2851	Bunning	4/14/2008	Referred to the Finance Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Refund Delivery Options National Taxpayer Advocate 2008 Report to Congress 427–441.	Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Senate Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
Small Business Issues				
Health Insurance Deduction/Self-Employed Individuals National Taxpayer Advocate 2001 Annual Report to Congress 223; National Taxpayer Advocate 2008 Annual Report to Congress 388–389.	Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.			
Legislative Activity 111th Congress	Pub. L. No. 111-124, § 2041 STAT 2560 (2010).			
	Bill Number	**Sponsor**	**Date**	**Status**
	S 725	Bingaman	3/26/2009	Referred to the Finance Committee
	HR 1470	Kind	3/12/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	S 2239	Bingaman	10/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 663	Bingaman	3/17/2005	Referred to the Finance Committee
	S 3857	Smith	9/16/2006	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 741	Sanchez	2/12/2003	Referred to the Ways & Means Committee
	HR 1873	Manzullo Velazquez	4/30/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	S 2130	Bingaman	4/15/2002	Referred to the Finance Committee

Married Couples as Business Co-owners National Taxpayer Advocate 2002 Annual Report to Congress 172–184.	Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of sub-chapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.			
Legislative Activity 110th Congress	Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, with an amendment
	S 842	Kerry	4/9/2003	Referred to the Finance Committee
	HR 1640	Udall	4/3/2003	Referred to the Ways & Means Committee
	HR 1558	Doggett	4/2/2003	Referred to the Ways & Means Committee
Income Averaging for Commercial Fishermen National Taxpayer Advocate 2001 Annual Report to Congress 226.	Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.			
Legislative Activity 108th Congress	Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).			
Election to be Treated as an S Corporation National Taxpayer Advocate 2004 Annual Report to Congress 390–393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, *U.S. Income Tax Return for an S Corporation*.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 2271	Franken	3/29/2012	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Regulation of Payroll Tax Deposits Agents National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Allow a small business corporation to elect to be treated as an S corporation by checking a box on it's timely filed Form 1120S U.S. Income Tax Return for an S Corporation.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Simplification				
Reduce the Number of Tax Preferences National Taxpayer Advocate 2010 Annual Report to Congress 365–372.	Simplify the complexity of the tax code generally by reducing the number of tax preferences.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee

Simplify and Streamline Education Tax Incentives National Taxpayer Advocate 2008 Annual Report to Congress 370–372; National Taxpayer Advocate 2004 Annual Report to Congress 403–422.	Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221, (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer, (3) the definitions for "Qualified Higher Education Expenses" and "Eligible Education Institution" should be simplified, (4) the income level and phase-out calculations should be more consistent under the various provisions, (5) all dollar amounts should be indexed for inflation, and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.			
Legislative Activity 112th Congress	**Bill Number**	**Sponsor**	**Date**	**Status**
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 3267	Schumer	6/6/2012	Referred to the Finance Committee
	HR 6522	Israel	9/21/2012	Referred to the Ways & Means Committee
Simplify and Streamline Retirement Savings Tax Incentives National Taxpayer Advocate 2008 Annual Report to Congress 373–374; National Taxpayer Advocate 2004 Annual Report to Congress 423–432.	Consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement plan for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
Tax Gap Provisions				
Corporate Information Reporting National Taxpayer Advocate 2008 Annual Report to Congress 388.	Require businesses that pay $600 or more during the year to non-corporate and corporate service providers to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 1796	Baucus	10/19/2009	10/19/2009 Placed on Senate Legislative Calendar under General Orders. Calendar No. 184
Reporting on Customer's Basis in Security Transaction National Taxpayer Advocate 2005 Annual Report to Congress 433–441.	Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B.			
Legislative Activity 110th Congress	Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).			
	Bill Number	**Sponsor**	**Date**	**Status**
	HR 878	Emanuel	2/7/2007	Referred to the Ways & Means Committee
	S 601	Bayh	2/14/2007	Referred to the Finance Committee
	S 1111	Wyden	4/16/2007	Referred to the Finance Committee
	HR 2147	Emanuel	5/3/2007	Referred to the Ways & Means Committee
	HR 3996 PCS	Rangel	10/30/2007	11/14/2007–Placed on the Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision
Legislative Activity 109th Congress	S 2414	Bayh	3/14/2006	Referred to the Finance Committee
	HR 5176	Emanual	4/25/2006	Referred to the Ways & Means Committee
	HR 5367	Emanual	5/11/2006	Referred to the Ways & Means Committee

IRS Forms Revisions National Taxpayer Advocate 2004 Annual Report to Congress 480; National Taxpayer Advocate 2010 Annual Report to Congress 40.	Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
IRS to Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS) National Taxpayer Advocate 2005 Annual Report to Congress 381–396.	Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Study of Use of Voluntary Withholding Agreements National Taxpayer Advocate 2004 Annual Report to Congress 478-489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).			
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336. 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Require Form 1099 Reporting for Incorporated Service Providers National Taxpayer Advocate 2007 Annual Report to Congress 494–496.	Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.			
Legislative Activity 111th Congress	Pub. L No. 111-148 § 9006 (2010). However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over $600, but Require Reporting on Corporate and Certain Other Payments, infra.			
Require Financial Institutions to Report All Accounts to the IRS by Eliminating the $10 Threshold on Interest Reporting National Taxpayer Advocate 2007 Annual Report to Congress 501–502.	Eliminate the $10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Revise Form 1040, Schedule C to Break Out Gross Receipts Reported on Payee Statements Such as Form 1099 National Taxpayer Advocate 2007 Annual Report to Congress 40.	Administrative recommendation that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee

Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099 National Taxpayer Advocate 2007 Annual Report to Congress 40.	Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: "Did you make any payments over $600 in the aggregate during the year to any unincorporated trade or business?" and "If yes, did you file all required Forms 1099?" S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Authorize Voluntary Withholding Upon Request National Taxpayer Advocate 2007 Annual Report to Congress 493–494.	Authorize voluntary withholding agreements between independent contractors and service recipients.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Require Backup Withholding on Certain Payments When TINs Cannot Be Validated National Taxpayer Advocate 2005 Annual Report to Congress 238–248.	Administrative recommendation that the IRS require payors to commence backup withholding if they do not receive verification of a payee's TIN. (S. 3795 would require voluntary withholding on certain payments.)			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Worker Classification National Taxpayer Advocate 2008 Annual Report to Congress 375–390.	Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Taxpayer Bill of Rights and *De Minimis* "Apology" Payments				
Taxpayer Bill of Rights National Taxpayer Advocate 2007 Annual Report to Congress 486–489.	Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
De Minimis "Apology" Payments National Taxpayer Advocate 2007 Annual Report to Congress 490.	Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide *de minimis* compensation to taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the IRC § 7811 definition of significant hardship.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Simplify the Tax Treatment of Cancellation of Debt Income				
Simplify the Tax Treatment of Cancellation of Debt Income National Taxpayer Advocate 2008 Annual Report to Congress 391–396.	Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	HR 4561	Lewis	2/2/2010	Referred to the Ways & Means Committee

Joint and Several Liability				
Tax Court Review of Request for Equitable Innocent Spouse Relief National Taxpayer Advocate 2001 Annual Report to Congress 128–165.	Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.			
Legislative Activity 109th Congress	Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).			
Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court). National Taxpayer Advocate 2004 Annual Report to Congress 490–92.	Allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.			
Legislative Activity 112th Congress	**Bill Number**	**Sponsor**	**Date**	**Status**
	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Ways & Means Committee
Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is *De Novo*. National Taxpayer Advocate 2011 Annual Report to Congress 531–536.	Amend IRC § 6015 to specify that the scope and standard of review in tax court determinations under IRC § 6015(f) is *de novo*.			
Legislative Activity 112th Congress	**Bill Number**	**Sponsor**	**Date**	**Status**
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee
Collection Issues				
Improve Offer In Compromise Program Accessibility National Taxpayer Advocate 2006 Annual Report to Congress 507–519.	Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.			
Legislative Activity 112th Congress	**Bill Number**	**Sponsor**	**Date**	**Status**
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee
	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee
Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens 2009 National Taxpayer Advocate Report to Congress 357–364.	Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFTL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.			
Legislative Activity 112th Congress	**Bill Number**	**Sponsor**	**Date**	**Status**
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 6439	Hastings	11/18/2010	Referred to the Ways & Means Committee

Permit the IRS to Release Levies on Small Business Taxpayers 2011 National Taxpayer Advocate Report to Congress 537–543.	Amend IRC § 6343(a)(1)(d) to: permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	HR 4368	McDermott	4/17/2012	Referred to the Ways & Means Committee
Return of Levy or Sale Proceeds National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House
	HR 586	Lewis	2/13/2001	4/18/02–Passed the House with an amendment; referred to the Senate
Reinstatement of Retirement Accounts National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343: ◆ § 401 – Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans ◆ § 408 – Individual Retirement Account, and SEP-Individual Retirement Account ◆ § 408A – Roth Individual Retirement Account			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in H.R. 1528 through an amendment and HR 1528 passed in lieu of S 882

Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Consolidation of Appeals of Collection Due Process (CDP) Determinations National Taxpayer Advocate 2004 Annual Report to Congress 451–470.	Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.			
Legislative Activity 109th Congress	Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).			
Partial Payment Installment Agreements National Taxpayer Advocate 2001 Annual Report to Congress 210–214.	Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the IRS.			
Legislative Activity 108th Congress	Pub. L. No. 108-357, § 833, 118 Stat. 1589-1592 (2004).			
Waiver of Installment Agreement Fees for Low Income Taxpayers National Taxpayer Advocate 2006 Annual Report to Congress 141–56 (Most Serious Problem: Collection Issues of Low Income Taxpayers).	Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State National Taxpayer Advocate 2009 Annual Report to Congress 346-350.	Provide that each Appeals office maintains separate office space, separate phone lines, facsimile, and other electronic communications access, and a separate post office address from any IRS office co-located with the Appeals office.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Penalties and Interest				
Interest Rate and Failure to Pay Penalty National Taxpayer Advocate 2001 Annual Report to Congress 179–182.	Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Interest Abatement on Erroneous Refunds National Taxpayer Advocate 2001 Annual Report to Congress 183–187.	Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 726	Sanchez	2/9/2005	Referred to the Ways & Means Committee

Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
First Time Penalty Waiver National Taxpayer Advocate 2001 Annual Report to Congress 188–192.	Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in the House
Federal Tax Deposit (FTD) Avoidance Penalty National Taxpayer Advocate 2001 Annual Report to Congress 222.	Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2//2005	Referred to the Ways & Means Committee
	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Family Issues				
Uniform Definition of a Qualifying Child National Taxpayer Advocate 2001 Annual Report to Congress 78–100.	Create a uniform definition of "qualifying child" applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).			
Means Tested Public Assistance Benefits National Taxpayer Advocate 2001 Annual Report to Congress 76–127.	Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or "not married" status.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
Credits for the Elderly or the Permanently Disabled National Taxpayer Advocate 2001 Annual Report to Congress 218–219.	Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 107th Congress	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee

Electronic Filing Issues				
Direct Filing Portal National Taxpayer Advocate 2004 Annual Report to Congress 471–477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Free Electronic Filing For All Taxpayers National Taxpayer Advocate 2004 Annual Report to Congress 471–477.	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	S 2861	Schumer	4/15/2008	Referred to the Finance Committee
Office of the Taxpayer Advocate				
Confidentiality of Taxpayer Communications National Taxpayer Advocate 2002 Annual Report to Congress 198–215.	Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to TAS.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Access to Independent Legal Counsel National Taxpayer Advocate 2002 Annual Report to Congress 198–215.	Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of *amicus* briefs.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	Referred to the Senate
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Taxpayer Advocate Directive National Taxpayer Advocate 2012 Annual Report to Congress 573–602; National Taxpayer Advocate 2002 Annual Report to Congress 419–422.	Amended IRC § 7811 to provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the Internal Revenue Service with respect to any program, proposed program, action, or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee

Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee

Other Issues

Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact

National Taxpayer Advocate 2008 Annual Report to Congress 419–422.

Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of $100,000 per individual per year and $200,000 per entity per year for failure to make special disclosures of a "listed transaction."

Legislative Activity 111th Congress

Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).

Bill Number	Sponsor	Date	Status
S 2771	Baucus	11/16/2009	Referred to the Finance Committee
HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
S 2917	Baucus	12/18/2009	Referred to the Finance Committee

Eliminate Tax Strategy Patents

National Taxpayer Advocate 2007 Annual Report to Congress 512–524.

Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.

Legislative Activity 112th Congress

Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).

Disclosure Regarding Suicide Threats

National Taxpayer Advocate 2001 Annual Report to Congress 227.

Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.

Legislative Activity 112th Congress

Bill Number	Sponsor	Date	Status
HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882
HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

Attorney Fees

National Taxpayer Advocate 2002 Annual Report to Congress 161–171.

Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees "above the line." Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.

Legislative Activity 108th Congress

Pub. L. No. 108-357, § 703, 118 Stat. 1546-1548 (2004).

Attainment of Age Definition

National Taxpayer Advocate 2003 Annual Report to Congress 308–311.

Amend IRC § 7701 by adding a new subsection as follows: "Attainment of Age. An individual attains the next age on the anniversary of his date of birth."

Bill Number	Sponsor	Date	Status
HR 4841	Burns	7/15/2004	7/21/2004–Passed the House; 7/22/2004–Received in the Senate

Legislative Activity 108th Congress

Home-Based Service Workers (HBSW)

National Taxpayer Advocate 2001 Annual Report to Congress 193–201.

Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.

Bill Number	Sponsor	Date	Status
HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
S 2129	Bingaman	4/15/2002	Referred to the Finance Committee

Legislative Activity 110th Congress

Legislative Activity 107th Congress

Restrict Access to the Death Master File National Taxpayer Advocate 2011 Annual Report to Congress 519–523.	Restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.			
Legislative Activity 112th Congress	**Bill Number**	**Sponsor**	**Date**	**Status**
	S 3432	Nelson	7/25/2012	Referred to the Finance Committee
	HR 6205	Nugent	7/26/2012	Referred to the Ways & Means Committee

LR #1

Simplify the National Status and Related Requirements for Qualifying Children

PROBLEM

Confusion arises when similar taxpayers receive different deductions or credits depending on the residence or national status of their children. The dependency deduction, child tax credit (CTC), and Earned Income Tax Credit (EITC), all of which relate to the cost of raising children, have different requirements. As explained in more detail below, a child who is not an American (citizen or national):

- May reside in the U.S., Canada, or Mexico for the dependency exemption;
- Must reside in the U.S. for the CTC; and
- Must reside in the U.S. with a Social Security number (SSN) for the EITC.[1]

Similarly situated taxpayers may fail to claim the correct benefits due to the inconsistency of these requirements.

EXAMPLE

The residence or national status of a child of a Canadian parent who works across the border in the United States may vary as follows: Even if her child stays in Canada while she commutes back and forth, the parent may claim the dependency deduction for U.S. income tax purposes. If the mother and child take up residence in the American border town where the workplace is located, the woman may claim the CTC in addition to the dependency deduction. If the mother and child are living in the U.S. and have SSNs, then the mother may also claim the EITC (for working parents). In all three situations, the working parent experiences similar obligations to support her child.

RECOMMENDATION

Simplify the three-part children's national status requirements in conformity with overall simplification of the family tax benefits as the National Taxpayer Advocate previously proposed, as follows:[2]

- Consolidate the dependency deduction and CTC (nonrefundable portion) with head of household filing status into a Family Credit.
- Consolidate and modify the EITC with the refundable portion of the CTC into a Worker Credit not contingent on qualifying children.
- For the Family Credit, apply contiguous country rule encompassing the U.S., Canada, and Mexico.

1 *See* Internal Revenue Code (IRC) §§ 152(b), 24(c), 32(c) & (m).

2 *See* National Taxpayer Advocate 2008 Annual Report to Congress 363 (Legislative Recommendation: *Simplify the Family Status Provisions*).

- For the Worker Credit, require an SSN valid for employment.
- Repeal as obsolete the residence rule that requires the child to be a citizen, national, or otherwise in the U.S.

PRESENT LAW

Under pertinent provisions, an independent American taxpayer may claim a dependency deduction for a child (or younger descendant or that of a sibling or step-sibling) who is a U.S. citizen or national, or a resident of the U.S., Canada, or Mexico, and who is under 19 (24 if a full-time student) and sharing the taxpayer's home for over half the year.[3] With income below certain phase-outs, the taxpayer may claim a $1,000 CTC for such a child under 17 who is a citizen, national, or resident of the U.S.[4] If the taxpayer earns low income, a portion of this credit, known as the additional CTC (ACTC), is refundable in excess of tax owed.[5]

A low income taxpayer may claim the refundable EITC with respect to such a child, if both taxpayer and child reside in the U.S. with SSNs valid for work.[6] If the taxpayer is married, a joint return reflecting the spouse's work-authorized SSN as well is necessary to claim the EITC.[7]

The return must reflect the child's Taxpayer Identification Number (TIN), satisfied by SSN in the case of the EITC.[8] In general, the Social Security Administration assigns SSNs to American citizens or work-authorized non-citizens.[9] An individual who has a U.S. tax filing requirement but who is not eligible for an SSN may apply to the IRS for an Individual Taxpayer Identification Number (ITIN).[10] Generally, citizens and residents of the United States file returns and pay tax on their worldwide income; noncitizens file and pay on earnings from work in the U.S. or certain other U.S. source income.[11]

3 *See* IRC §§ 151(c), 152(b), (c). Eligible Canadians, Mexicans, Koreans, and Indians may claim these deductions. *See* IRC § 873(b); U.S.-Republic of Korea Income Tax Convention, Art. 4(7); U.S.-India Income Tax Convention, Art. 21(2).

4 *See* IRC § 24(a) ($1,000 in 2012), (b), (c).

5 *See* IRC § 24(d).

6 *See* IRC § 32(c), (m).

7 *See* IRC § 32(d).

8 *See* IRC §§ 24(e); 32(m); 151(e).

9 *See* 42 U.S.C. § 405(c)(2)(B)(i). Generally, U.S. law authorizes work in specified occupations by noncitizens, whose children's immigration status may derive from theirs. *See* U.S. Citizenship & Immigration Serv. (CIS), Working in the United States (Jan. 26, 2012) *available at* http://www.uscis.gov/portal/site/uscis/menuitem.eb1d4c2a3e5b9ac89243c6a7543f6d1a/?vgnextoid=a39e901bf9873210VgnVCM100000082ca60aRCRD&vgnextchannel=a39e901bf9873210VgnVCM100000082ca60aRCRD (last visited Dec. 13, 2012); CIS, *I Am a Permanent Resident: How Do I Help My Relative Become a U.S. Permanent Resident?* No. B1 – M-561 (Aug. 2008).

10 See Treas. Reg. § 301.6109-1(d).

11 *See* IRC §§ 61, 861.

REASONS FOR CHANGE

Reports by the Treasury Inspector General for Tax Administration (TIGTA) have attracted headlines with the insinuation that the IRS has paid billions of dollars in invalid ACTC claims, *i.e.*, those with ITINs rather than SSNs.[12] Although the IRS has confirmed that the ACTC law does not require SSNs but permits ITINs, TIGTA asserts that the same legislative intent that applies to EITC should apply to ACTC.[13] While TIGTA's assertion does not reflect the current state of the law, it does demonstrate the need for additional clarification.

In effect, Congress has reaffirmed the rule that permits ITINs by leaving it intact in substantive amendments of the CTC statute enacted as recently as the American Recovery and Reinvestment Act of 2009.[14] Congress may have had a rational basis for reaffirmation. As then-Commissioner of Internal Revenue Mark Everson (who previously had served as Deputy Commissioner of the Immigration and Naturalization Service) testified to the House of Representatives Committee on Ways and Means in 2006: "ITINs are issued regardless of immigration status because noncitizens may have U.S. tax return and payment responsibilities under the Internal Revenue Code."[15]

Nevertheless, confusion leading to erroneous claims or omissions arises because of the inconsistency among the requirements for child-related tax benefits. These requirements reflect a few alternative principles. One principle is ability to pay. The dependency deduction, supplemented by the CTC, reflects the cost of raising children, which reduces the taxpayer's income, or ability to pay tax.[16]

Another principle is that of a domestic subsidy. The EITC operates as a wage supplement, which Congress has limited to authorized American workers. To the extent that it enhances earned income, the ACTC is a similar subsidy, which Congress decided to limit by law, generally, to a taxpayer who has a qualifying child who is a citizen, national, or resident of the United States.[17]

A third principle is administrability. Limiting dependents to those with a TIN in the U.S. or a contiguous country facilitates IRS verification of the claimed deduction.[18] For clarification, legislation should organize these various principles into simplified provisions that taxpayers can use and the IRS can administer.

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12 *See* TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the ITIN Program to Detect Fraudulent Applications* 2012-42-081 (Jul. 16, 2012); TIGTA, Ref. No. 2009-40-057, *Actions Are Needed to Ensure Proper Use of ITINs and to Verify or Limit Refundable Credit Claims* 2009-40-057 (Mar. 31, 2009); Josh Lederman, *IRS Discouraged Fraud Detection in ID Program, Assoc.* Press (Aug. 8, 2012).

13 *See* TIGTA, *Actions Are Needed* at 17 ("the language of the law is such that it could be interpreted to apply to the ACTC"), 31 (IRS response).

14 *See* Pub. L. No. 111-5, Div. B, § 1003, 123 Stat. 115, 313 (2009).

15 *See Impacts of Border Security and Immigration on Ways and Means Programs, Hearing Before the House Comm. on Ways and Means*, 109th Cong. 2nd Sess. 16 (2006) (statement of Mark W. Everson, Comm'r of Int. Rev.).

16 *See* Boris I. Bittker & Lawrence Lokken, Federal Taxation of Income, Estates & Gifts ¶ 30.1 (Thomson/Res. Inst. of Amer. 2012).

17 On subsidies, see sources discussed in National Taxpayer Advocate 2010 Annual Report to Congress, Vol. 2 at 101 (Research Study: *Evaluate the Administration of Tax Expenditures*).

18 *See* Bittker & Lokken, Federal Taxation of Income ¶ 30.3.

EXPLANATION OF RECOMMENDATION

Originally, the income tax law allowed deductions for personal and dependency exemptions without geographic limits.[19] With the advent of World War II, the Commissioner found there were more claims for European children than the IRS could verify.[20] Consequently, the Individual Income Tax Act of 1944 enacted the contiguous country rule.[21] Subsequently, the Tax Reform Act of 1986 imposed the TIN requirement to facilitate IRS verification of dependency deductions.[22] In 1997, the Taxpayer Relief Act created the CTC and ACTC in part to supplement the dependency deduction, reflecting increased costs of raising children.[23]

Although a 1924 forerunner credit generally reduced the liability of those who paid income tax, it was not until the Tax Reduction Act of 1975 that Congress enacted the refundable EITC as a targeted anti-poverty measure.[24] In 1996, the Personal Responsibility and Work Opportunity Reconciliation Act substantially reformed traditional welfare programs, and in conjunction, required work authorization for an expanded EITC amount.[25]

Since 2001, the National Taxpayer Advocate has repeatedly recommended simplification of family income tax provisions.[26] The Working Families Tax Relief Act of 2004 enacted a Uniform Definition of a Qualifying Child, responding in part to the National Taxpayer Advocate's recommendations.[27] This legislation simplified the requirements for the dependency deduction, CTC, and EITC, as well as head of household filing status and child care credit, by generally eliminating the need to document expenses for supporting a child of a prescribed age, relationship, and residence.

In 2008, the National Taxpayer Advocate recommended consolidating the various family-related provisions into a Family and a Worker Credit.[28] The Family Credit would reflect the costs of maintaining a household and raising a family. Without income phase-outs, this refundable credit would incorporate all current family provisions based on the composition of the family unit, allowing a claim for every qualifying child. The refundable Worker Credit would subsidize low wages, creating a work incentive for an individual, irrespective of any qualifying children.

19 *See* Pub. L. No. 65-50, § 1203 (1917).

20 *See Gitter v. Comm'r*, 13 T.C. 520, 526-27 (1949) (discussing legislative history).

21 *See* Pub. L. No. 78-315, 58 Stat. 231 (1944).

22 *See* Jt. Comm. on Tax'n, *General Explanation of the Tax Reform Act of 1986*, 99th Cong. 2d Sess. 1286-87 (1987).

23 *See* Pub. L. No. 105-34, § 101, 111 Stat. 796 (1997); IRC § 24(d), *amended by* Pub. L. No. 107-16, § 201 (2001) (expanding refundability); Sen. Rep. 105-33, 105th Cong. 1st Sess. 3 (1997); H. Rep. 105-48, 105th Cong. 1st Sess. 310 (1997).

24 *See* Pub. L. No. 68-176, § 209, 43 Stat. 253 (1924); Pub. L. No. 94-12, 89 Stat. 26 (1975).

25 *See* Pub. L. No. 104-193, § 451, 110 Stat. 2105, 2276 (1996).

26 *See* National Taxpayer Advocate 2001 Annual Report to Congress 76 (Legislative Recommendation: *Family Status Issues*).

27 *See* Pub. L. No. 108-311, § 201 *ff.*, 118 Stat. 1166 (2004).

28 *See* National Taxpayer Advocate 2008 Annual Report to Congress 363 (Legislative Recommendation: *Simplify the Family Status Provisions*); *see also* National Taxpayer Advocate 2006 Annual Report to Congress 463 (Legislative Recommendation: *Uniform Definition of Qualifying Child*); Pres. Advisory Panel on Fed. Tax Reform, *Simple, Fair & Pro-Growth: Proposals to Fix America's Tax System* 60 *ff.* (2005).

Assuming this simplification through bifurcation of the family tax provisions, resolution of the national requirements for children should follow suit. In sum, current law that allows children with TINs to reside in the U.S. or contiguous countries would persist under the Family Credit, reflecting ability to pay. The current EITC requirement of an SSN valid for employment would persist, but only for the Worker Credit, to which it logically applies. The current rule applicable to the CTC (and ACTC), which generally requires that a qualifying child be a citizen, national, or resident of the United States, would become obsolete, since the CTC and ACTC would be subsumed by the Family and Worker Credits. Obsolescence of this rule would resolve the confusion surrounding the national status of children who qualify for a refundable credit.

LR #2

Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered "Not Married"

PROBLEM

Married taxpayers must file joint returns in order to claim important tax benefits such as the Earned Income Tax Credit (EITC).[1] Marital status is determined under IRC § 7703, which permits some married taxpayers to be "considered as" not married. So long as these married taxpayers meet the other pertinent statutory requirements, they will be entitled to the tax benefits claimed on their separate returns.[2]

IRC § 7703(b), however, prevents taxpayers from being considered "not married" in two ways. First, the statute retains an outdated "cost of maintaining a household" test that disproportionately affects members of racial and ethnic minorities who work and have children.[3] Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year's end.

EXAMPLE

From January through August, a married couple with two children under the age of 13 lived together, with the husband (H) paying for all of the cost of maintaining the household. The couple became estranged and H moved out of the family home in September. The wife (W) could not afford to maintain the household on her own, so she and the children moved in with W's mother. W enrolled in college courses to improve her chances of finding a good job. H and W entered into a legally binding written separation agreement in October. Because the couple was never legally separated under a decree of divorce or separate maintenance,[4] and H and W were not members of separate households for the last six months of the year, neither will be considered "not married." Neither H nor W will be

1 These tax benefits are found in Code provisions such as: IRC §§ 21(e)(2) (child-care credit); 22(e)(elderly or disabled credit); 25A(g)(6) (Lifetime Learning, Hope Scholarship, and American Opportunity Tax Credits); 32(d) (EITC); 36C(f)(1) (adoption credit); 135(d)(3) (U.S. savings bond interest exclusion for college expenses); 137(e) (adoption exclusion); 163(h)(4)(A)(ii) (home mortgage interest deduction); and 221(e) (student loan interest deduction). Of these provisions, the EITC generally provides the largest benefit. The EITC is a refundable credit that in 2011 was potentially as high as $3,094 for one qualifying child, $5,112 for two qualifying children, and $5,751 for three qualifying children. *See* IRS 1040 Instructions (2011) *available at* http://core.publish.no.irs.gov/instrs/pdf/24811y11.pdf (last visited Dec. 21, 2012).

2 A married taxpayer who is considered as not married may file a separate return using a filing status of Single or, if the requirements of IRC § 2(b) are also met, as a Head of Household (HoH). IRC § 2(c) provides: "For purposes of this part, an individual shall be treated as not married at the close of the taxable year if such individual is so treated under the provisions of section 7703(b)."

3 See The Ohio State University Research and Innovation Communications, *Marital Separations an Alternative to Divorce for Poor Couples* (Aug.13, 2012), describing research by Dmitry Tumin and Zhenchao Qian, *available at* http://researchnews.osu.edu/archive/maritalsep.htm (last visited Dec. 21, 2012), discussed below. As part of her 2001 recommendation to adopt a Uniform Definition of a Child (UDOC), the National Taxpayer Advocate recommended removing the "cost of maintaining a household test" in IRC § 7703(b). National Taxpayer Advocate 2001 Annual Report to Congress 78 (Key Legislative Recommendation: *Family Status Issues*).

4 Differently from a consensual separation agreement between the parties, a decree for separate maintenance refers to court-ordered payments by one spouse to another when they are no longer living together. *Black's Law Dictionary*, 9th ed. (2009).

eligible to claim tax benefits such as EITC or the Lifetime Learning credit on their separate returns even if they otherwise meet the requirements for those tax benefits.

Even if H had moved out of the home in June rather than September, neither H nor W could claim tax benefits with respect to the children on their separate returns because they still would not meet the requirements of IRC § 7703 that would permit them to be considered as not married. Because the children would not be H's qualifying children, H could not claim them as dependents on his separate return as required under IRC § 7703(b)(1).[5] W did not furnish over half the cost of maintaining the household as required by IRC § 7703(b)(2). Thus, W would also not be considered as not married and would not be entitled to claim tax benefits such as EITC with respect to the children, or the Lifetime Learning credit, on her separate return.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered "not married."

CURRENT LAW

The Dependency Exemption Provisions Have Rules for Divorced or Separated Parents that Since 1967 Have Recognized Written Separation Agreements.

As Congress noted in 1966, "[o]ne of the problems which arises most frequently under the individual income tax provisions of the Internal Revenue Code of 1954 is the question of which of divorced or separated parents is entitled to the deduction for personal exemption with respect to their children."[6] The general rule required a taxpayer to have provided over half the claimed dependent's support.[7] Section 152(e) was added to the Code to clarify how divorced or separated parents could meet this requirement.[8] From its inception, the provision encompassed not only taxpayers who were separated under a decree of divorce or separate maintenance, but also those who were "separated under a written separation

5 W is the custodial parent because she had custody of the children for a greater part of the year. IRC § 152(e)(4)(A). Consequently, they will be treated as her qualifying children. IRC § 152(e)(1)(B). On her separate return, W is entitled to claim the dependency exemption for the children under IRC § 151.

6 H.R. Rep. No. 102, Comm. on Ways and Means, to accompany H.R. 6056, 90th Cong. 1st Sess. (Mar. 8, 1967).

7 Prior to its amendment by The Working Families Tax Relief Act, Pub. L. No. 108-311, § 201, 118 Stat. 1166, 1169 (Oct. 5, 2004), IRC § 152(a) provided, in part, "For purposes of this subtitle, the term 'dependent' means any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer (or is treated under subsection (c) or (e) as received from the taxpayer)."

8 Pub. L. No. 90-78, 81 Stat. 191 (Aug. 31, 1967). The provision has been amended several times, often with the support of the National Taxpayer Advocate. *See, e.g.*, National Taxpayer Advocate 2001 Annual Report to Congress 78 (Legislative Recommendation: *Family Status Issues*); National Taxpayer Advocate 2006 Annual Report to Congress 463 (Legislative Recommendation: *Uniform Definition of Qualifying Child*); National Taxpayer Advocate 2008 Annual Report to Congress 363 (Legislative Recommendation: *Simplify the Family Status Provisions*).

agreement."[9] Section 152(e) was amended over the years, including in 2004 to reflect the passage of the Uniform Definition of a Child (UDOC), discussed below, but the notion that a written separation agreement served the same purpose as a decree of divorce or separate maintenance was left undisturbed.[10] Today, only married taxpayers who have neither a court decree nor a written separation agreement are required to live in separate households for the last six months of the year in order to come within the bounds of IRC § 152(e).

A "Cost of Maintaining a Household" Test Was Indirectly Added to Tax Benefit Provisions such as EITC by a Definitional Statute.

The EITC was enacted as part of the Tax Reduction Act of 1975.[11] As the National Taxpayer Advocate recounted in 2001,

> The Earned Income Tax Credit was to provide relief to workers with dependent children who pay little or no income taxes but were subject to the social security payroll tax on their earnings. Because it would increase their after-tax earnings, the credit, in effect, was anticipated to provide an added bonus or incentive for low income people to work, and therefore, of importance in inducing individuals with families receiving Federal assistance to support themselves. It was also expected to be effective in stimulating the economy because the low-income people were expected to spend a large fraction of their increased disposable incomes. Senate Report No. 94-36; 1st Session; H.R. 2166, March 17, 1975; II — Reasons for the Bill — Earned Income Tax Credit; Tax Reduction Act of 1975.[12]

The EITC statute requires that the qualifying child reside with the taxpayer for more than half the year at the taxpayer's principal place of abode, which must be within the United States, and provides tie-breaker rules when the child is the "qualifying child" of more than one taxpayer.[13] The statute has never required a taxpayer to provide more than half the cost of maintaining a household. However, as originally enacted, the EITC statute provided

9 IRC § 152(e)(1)(a) as enacted in 1967 applied if a child "receives over half of his support during the calendar year from his parents who are divorced or legally separated under a decree of divorce or separate maintenance, or who are separated under a written separation agreement." In *Leggett v. Comm'r*, 329 F.2d 509, 510 (2d Cir. 1964), a decree of separate maintenance was contemplated by a Florida statute providing: "Alimony unconnected with divorce. If any of the causes of divorce set forth in § 65.04 shall exist in favor of the wife, and she be living apart from her husband, she may obtain alimony without seeking a divorce upon bill filed and suit prosecuted as in other chancery causes; and the court shall have power to grant such temporary and permanent alimony and suit money as the circumstances of the parties may render just; but no alimony shall be granted to an adulterous wife."

10 IRC § 152(e)(1)(A)(iii). IRC § 152(e)(1) now applies if a child "receives over half of his support during the calendar year from the child's parents – (i) who are divorced or legally separated under a decree of divorce or separate maintenance, (ii) who are separated under a written separation agreement, or (iii) who live apart at all times during the last 6 months of the calendar year." The taxpayer with whom the child resided, or who had custody of the child, for the longest period of time during the year is generally entitled to the dependency exemption. IRC § 152(c)(4)(B)(i) (where the provisions of 152(e) do not apply); IRC § 152(e)(1)(B); (e)(4)(A).

11 Pub. L. No. 94-12, § 204 (a), 89 Stat. 26, 30 (Mar. 29, 1975), adding new IRC § 43 (now IRC § 32).

12 National Taxpayer Advocate 2001 Annual Report to Congress 78, 87 (Legislative Recommendation: *Family Status Issues*).

13 IRC § 32(c)(1)(A)(ii)(I) imposes the principal place of abode requirement; IRC § 32(c)(3)(A) defines "qualifying child" by cross referencing IRC §152(c), which includes tie-breaker rules that prevent the duplication of benefits.

that "in the case of an individual who is married (within the meaning of section 143), this section shall apply only if a joint return is filed for the taxable year."[14]

The cited section 143, *Determination of Marital Status*, the predecessor of today's IRC § 7703, contained the general rule that "[a]n individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married."[15] In contrast to IRC § 152, section 143 did not contemplate a written separation agreement as serving the same purpose as a divorce decree. Section 143 also did not impose a household maintenance requirement.

In 1969, to "make provision for a family abandoned by one of the parents," section 143 was amended by adding subsection (b), *Certain Married Individuals Living Apart*.[16] Under the new rule, a taxpayer who was married but living apart from his or her spouse would be "considered as" not married if:

1. He or she filed a separate return and maintained as his or her home a household which constituted, for more than one-half of the taxable year, the principal place of abode of a dependent with respect to whom the taxpayer was entitled to a deduction for the taxable year under IRC § 151;
2. He or she furnished over half of the cost of maintaining the household during the taxable year; and
3. During the entire taxable year, his or her spouse was not a member of the household.[17]

Thus, the second and third requirements imposed new substantive requirements for married taxpayers to be "considered as" not married, and thereby eligible to claim tax benefits like EITC on a separate return. Section 143 was amended again in 1984 to require that the taxpayer not have been a member of the same household as his or her spouse for the last six months of the year, rather than for the entire tax year.[18] The section was redesignated as IRC § 7703 in 1986.[19]

In the years following enactment of the EITC, other statutes provided important tax benefits, and required married taxpayers to file joint returns in order to claim them. Some

14 IRC § 43(d) (1975).

15 Section 143 was redesignated as IRC § 7703 in 1986 by Pub. L. No. 99-514, Tit. XIII, § 1301(j)(2)(A), 100 Stat. 2085, 2657 (Oct. 22, 1986).

16 Jt. Comm. on Internal Revenue Taxation, General Explanation of the Tax Reform Act of 1969, 219, 91st Cong. (Dec. 23, 1970).

17 IRC § 143, as amended by Pub. L. No. 91-172, § 802(b), 83 Stat. 487, 677 (Dec. 30, 1969).

18 Pub. L. No. 98-369, § 423, 98 Stat. 494, 799 (July 18, 1984). The rules for filing as HoH under IRC § 2 were also changed to require the taxpayer to maintain a household as the principal place of abode for a child for more than half the year, rather than for an entire year. Section 143 was then designated as IRC § 7703, which was amended over the years to reference IRC §152 and to reflect some changes in terminology brought about by UDOC.

19 Section 143 was redesignated as IRC § 7703 in 1986 by Pub. L. No. 99-514, Tit. XIII, § 1301(j)(2)(A), 100 Stat. 2085, 2657 (Oct. 22, 1986).

statutes contain their own "cost of maintaining a household" test.[20] Some, like EITC, do not have a "cost of maintaining a household" test, but like EITC, they cross reference IRC § 7703 for a definition of marital status.[21] In this manner, the "cost of maintaining a household" test has been imposed on those provisions as well - by the definitional statute.

The Uniform Definition of a Child Simplified Five Related Code Provisions in 2004, but Did Not Affect IRC § 7703(b).

In 2004, enactment of a uniform definition of a qualifying child (UDOC) simplified five related provisions.[22] The "support test," which required taxpayers to show that they furnished more than half the support of their claimed dependents, was repealed as obsolete in most cases. Instead, a more pragmatic and less burdensome UDOC concept allowed claims as long as the "qualifying child" satisfies the three requisite tests of age, residency, and relationship to the taxpayer. The UDOC legislation applied to the dependency exemption,[23] the Child Tax Credit (CTC),[24] the Earned Income Tax Credit (EITC),[25] the Child and Dependent Care Credit (CDCC),[26] and Head of Household (HoH) filing status (collectively known as the "family status" provisions).[27] Despite a recommendation by the National Taxpayer Advocate, Congress did not apply UDOC to the determination of marital status under IRC § 7703.[28] Thus, the "cost of maintaining a household" test remains intact in IRC § 7703(b), even though that test and the "support" test do not now apply to most taxpayers.[29]

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20 For example, IRC § 21(e)(4) requires a married taxpayer living apart from his or her spouse and filing a separate return to maintain a household and furnish over half the cost of maintaining the household to claim the child-care credit. IRC § 36C(f)(1) imposes the same requirements for the adoption credit by cross referencing to IRC § 21(e)(4), and not to IRC § 7703. IRC § 137(e) imposes the same requirement for the adoption exclusion by cross referencing to IRC § 36C(f), and not to IRC § 7703. In addition, IRC § 2(b)(1)(flush language) requires taxpayers to "maintain a household," which means furnishing over half the cost of maintaining the household, to file as head of household.

21 *See, e.g.*, IRC §§ 22(e)(elderly or disabled credit, cross-referencing IRC § 7703); 25A(g)(6) (Lifetime Learning, Hope Scholarship, and American Opportunity Tax Credits, cross-referencing IRC § 7703); 135(d)(3) (U.S. savings bond interest exclusion for college expenses, cross-referencing IRC § 7703); 221(e) (student loan interest deduction, cross-referencing IRC § 7703).

22 The Working Families Tax Relief Act, Pub. L. No. 108-311, § 201, 118 Stat. 1166, 1169 (Oct. 5, 2004). Congress made further revisions to UDOC in Pub. L. No. 109-135, § 404(a), 119 Stat. 2577, 2632 (Dec. 21, 2005), and Pub. L. No. 110-351, § 501, 122 Stat. 3949, 3979 (Oct. 7, 2008). The National Taxpayer Advocate recommended adopting UDOC in 2001. *See* National Taxpayer Advocate 2001 Annual Report to Congress 78 (Key Legislative Recommendation: *Family Status Issues*).

23 IRC §§ 151, 152.

24 IRC § 24(c)(1).

25 IRC § 32(c)(3). The UDOC legislation also replaced the tie-breaker rules previously found in IRC 32(C)(1)(c) with those found in IRC § 152.

26 IRC § 21(b)(1).

27 IRC § 2(b)(1).

28 IRC § 7703(b)(1).

29 IRC § 2 imposes the home maintenance test. IRC §§ 152 and 21 had the child support test. *See* H.R. Conf. Rep. No. 108-696, accompanying H.R. 1308, the Working Families Tax Relief Act of 2004 (Sept. 23, 2004). IRC §§ 24 and 32 did not contain support tests, and the EITC requirements of age, relationship, and residency are now part of UDOC's definition of a "qualifying child." Under UDOC eligibility rules, a dependent must be either a "qualifying child" or a "qualifying relative." IRC § 152(a). Because not all taxpayers' living or family arrangements could satisfy the "qualifying child" tests, Congress retained the support and maintenance tests for satisfying the "qualifying relative" rules. See IRC § (d)(1)(C). For a more detailed description of the Qualifying Child and Qualifying Relative rules, see 2010 Annual Report to Congress 487 Most Litigated Issue: *Family Status Issues Under Internal Revenue Code Sections 2, 24, 32, and 151.*

As the National Taxpayer Advocate has observed, the new UDOC rules created winners and losers, which is a price of tax simplification.[30] However, IRC § 7703(b) is a definitional statute that has remained essentially unchanged since 1984, has indirectly been made a part of other statutes by virtue of cross referencing, and prevents taxpayers most in need of tax benefits from claiming them.

REASONS FOR CHANGE

Married taxpayers must file joint returns to be entitled to important tax benefits, and the provisions in IRC § 7703(b) that allow estranged taxpayers to be considered as not married may inappropriately limit the availability of those benefits to otherwise eligible taxpayers. Specifically, IRC § 7703(b) prevents a married taxpayer living apart from his or her spouse who by year-end has an enforceable separation agreement and custody of qualifying children for the greater part of the year from receiving a variety of tax benefits on a separate return. This is because IRC § 7703(b)(3), in contrast to the dependency exemption provisions, requires such individuals to live in a household separate from their estranged spouses for the last six months of the year to be considered as not married.

Even taxpayers who meet the six-month separation requirement may not be considered as "not married" because they cannot meet the "cost of maintaining a household" requirement in IRC § 7703(b)(2). This requirement disproportionately affects the very population intended to benefit from provisions such as EITC. In a long-term Ohio State University study of 7,272 people across the U.S., participants in the study were married at some point.[31] The same people were surveyed every year from 1979 up to 1994 and every other year thereafter through 2008. Some study findings are:

- 15 percent of separations did not end in either divorce or reconciliation within 10 years;
- Couples in these prolonged separations tended to be racial and ethnic minorities, have young children, and have low family income and education;
- Those who remained separated are more disadvantaged than those who divorced;
- Those who separated without divorcing tended to have more children, compared to those who divorced.

As one of the study authors noted, "no-fault divorces reduced or eliminated separation as a prerequisite for divorce. That means people who have long-term separations now may

30 National Taxpayer Advocate 2006 Annual Report to Congress 463 (Legislative Recommendation: *Uniform Definition of Qualifying Child*).

31 *See* The Ohio State University Research and Innovation Communications, *Marital Separations an Alternative to Divorce for Poor Couples* (Aug.13, 2012), describing research by Dmitry Tumin and Zhenchao Qian, *available at* http://researchnews.osu.edu/archive/maritalsep.htm (last visited Dec. 21, 2012). The 7,272 study participants were drawn from the 12,686 participants in the National Longitudinal Survey of Youth of 1979, a nationally representative sample of men and women aged 14 to 22 in 1979.

not have the financial or social resources to divorce."[32] U.S. Census data show that most children in mother-only or father-only households live with a parent in the labor force.[33]

These working single parents who are too poor to divorce will not be eligible for tax benefits they need if they are also too poor to furnish more than half the cost of maintaining the household. For example, they may be recipients of federal or state assistance programs such as Temporary Assistance for Needy Families (TANF).[34] In fiscal year 2010 more than 1.8 million families on average received TANF assistance each month.[35] Only about 12 percent of TANF families had earned income, $823 per month on average.[36] According to the U.S. Census Bureau, the median monthly housing cost is $927.[37]

Alternatively, some taxpayers live in multi-generational families (*i.e.*, those with two adult generations, those with three or more generations, or two skipped generations such as a grandparent and grandchild).[38] Members of multi-generational households pool resources and share costs as a means of meeting their economic needs.[39] While more than one in five young adults (ages 25 to 34) lived in multi-generational households in 2009, only 13.1 percent of whites did so, compared to 23.7 percent of blacks and 23.4 percent of Hispanics.[40]

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32 *Id.*, quoting Zhenchao Qian.

33 *See* Julia Overturf Johnson, Robert Kominsky, Kristin Smith, and Paul Tillman, U.S. Census Bureau, *Changes in the Lives of U.S. Children: 1990-2000*, Table E4 (Nov. 2005), *available at* http://www.census.gov/population/www/documentation/twps0078/twps0078.html (last visited Dec. 21, 2012), reporting that "In 2000, a little over one-quarter of all children lived with a single parent, having increased 2.7 percentage points during the decade. A majority of children in single-parent families were living with a parent in the labor force."

34 Under the TANF program, states receive block grants to design and operate programs that accomplish one of the purposes of the TANF program: provide assistance to needy families so that children can be cared for in their own homes; reduce the dependency of needy parents by promoting job preparation, work and marriage; prevent and reduce unplanned pregnancies among single young adults; and encourage the formation and maintenance of two-parent families. *See* U.S. Dep't of Health and Human Services, Office of Family Assistance, Temporary Assistance for Needy Families (TANF), *available at* http://www.acf.hhs.gov/programs/ofa/programs/temporary-assistance-for-needy-families-tanf (last visited Dec. 21, 2012). In the District of Columbia, applicants must answer "no" to all of the following questions in order to be eligible for assistance: "Will your household income be more than $150 this month?"; "Do you have more than $100 in cash or in the bank?"; and "Is your income this month more than your housing costs (rent and utilities)?" *See* Government of the District of Columbia Department of Human Services Income Maintenance Administration, *Combined Application for DC Medical Assistance Food Stamps Cash Assistance for the Disabled and Families with Children, available at* http://dhs.dc.gov/sites/default/files/dc/sites/dhs/publication/attachments/combinedform_eng1.pdf (last visited Dec. 21, 2012).

35 The average monthly number of TANF families was 1,847,155 in fiscal year 2010. U.S. Dep't of Health and Human Services, Office of Family Assistance, *Characteristics and Financial Circumstance of TANF Recipients, Fiscal Year 2010* (Aug. 8, 2012), *available at* http://www.acf.hhs.gov/programs/ofa/resource/character/fy2010/fy2010-chap10-ys-final (last visited Dec. 21, 2012). The average number of persons in TANF families was 2.4, including an average of 1.8 recipient children.

36 *Id.*

37 U.S. Census Bureau, 2011 American Housing Survey, table C-10-AO-Geography-United States: Housing Costs-All Occupied Units (National). Median housing costs vary by location. Within a metropolitan area in a central city, median monthly housing costs are $924. Within a metropolitan area not in a central city, median monthly housing costs are $1,064. Outside metropolitan areas, median housing cost are $657 (values exclude "no-cash rent," which the US Census Bureau describes as a housing unit owned by friends or relatives who live elsewhere and who allow occupancy without charge or rent-free units provided to compensate caretakers, ministers, tenant farmers, sharecroppers, or others. *See Definitions of Subject Characteristics, available at* http://www.census.gov/geo/lv4help/apen_bhous.html (last visited Dec. 21, 2012).

38 *See* Rakesh Kochhar and D'Vera Cohn, *Fighting Poverty in a Tough Economy, Americans Move in with Their Relatives*, Pew Research Center 23 (Oct. 3, 2011).

39 Generations United, in *Family Matters: Multigenerational Families in a Volatile Economy* 14 (2011), notes that "By pooling resources and sharing costs, multigenerational families can stretch food budgets and make big-ticket expenses such as rent and transportation."

40 Rakesh Kochhar and D'Vera Cohn, *Fighting Poverty in a Tough Economy, Americans Move in with Their Relatives*, Pew Research Center 23, 29 (Oct. 3, 2011).

According to Pew Research Center, while in a "traditional" household, the head of household typically accounts for 85.7 percent of income, in a multi-generational household the household head typically accounts for less than half (48.8 percent in 2009) of income.[41] Just as no one family member is likely to earn more than half the household income in a multi-generational household, it may be that no one family member pays more than half the cost of maintaining the household. In that case, no member of the household would be able to meet the requirements of IRC § 7703.

Not only does IRC § 7703 not reflect the economic reality of families intended to benefit from provisions like EITC, it is not in keeping with the changes in related statutes brought about by UDOC legislation. Because the "support" test is no longer operative and tie-breaker rules prevent duplication of benefits, the additional "cost of maintaining a household" test is unnecessary and burdensome.

EXPLANATION OF PROVISION

The proposal would amend IRC § 7703 to remove the "cost of maintaining a household" test. The proposal would also amend IRC § 7703 to permit married individuals with legally binding separation agreements and who are not members of the same household by the end of the taxable year to be considered as not married. Consequently, they could file separate returns and one of them may be able to claim tax benefits such as EITC, if otherwise eligible. Removing the household maintenance test which disproportionately affects low income working parents and recognizing the validity of a written separation agreement of estranged spouses would provide greater consistency with related Code provisions. The proposal would allow one of the parents to claim important tax benefits that would otherwise be available to neither.

41 *Id.* at 46.

LR #3

Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes

PROBLEM

As of fiscal year (FY) 2011, over 104,000 children were waiting to be adopted in the United States.[1] Of the nearly 50,000 children adopted through public agencies that year, some 84 percent were considered to have special needs.[2] Congress enacted the adoption credit, in part, to defray the costs of adopting these children.[3] Between January 1, 2003, and December 31, 2012, a taxpayer adopting a child who has been determined by a State to have special needs could claim an adoption tax credit of $10,000, plus an inflation adjustment, even if the adoptive parent paid no actual qualified adoption expenses in connection with the adoption (hereafter referred to as the special needs adoption credit). The special needs adoption credit is permanent, although the rules for claiming the credit after 2012 may become more restrictive.[4]

A "child with special needs" is defined as a child whom a State has determined cannot or should not be returned to the home of his parents, and the State has also determined has a specific factor or condition making it reasonable to conclude that placement of the child with adoptive parents requires adoption assistance.[5] Examples of a specific factor or condition include:

- Ethnic background;
- Age;
- Membership in a minority or sibling group;
- Medical conditions; or
- Physical, mental, or emotional handicaps.[6]

1 See Children's Bureau, U.S. Dep't of Health & Human Services, The AFCARS Report: Preliminary FY 2011 (2011) *available at* http://www.acf.hhs.gov/sites/default/files/cb/afcarsreport19.pdf.

2 See Children's Bureau, U.S. Dep't of Health & Human Services, ACF Report FY 2011 (2011) *available at* http://www.acf.hhs.gov/sites/default/files/cb/special_needs_2011.pdf.

3 See H.R. Rep. No. 107-64, at 13 (2001). At the time this report went to print, the credit was scheduled to sunset at the end of 2012, except for adoptions of children with special needs. See Pub. L. No. 111-312, § 101(b), 124 Stat. 3296, 3298 (2010).

4 Absent a legislative change, the adoption credit for children with special needs will revert to the provisions found in § 23 between January 1, 1997, and December 31, 2001. The credit will be capped at $6,000, the adoptive parents of children who have been determined by a State to have special needs will be required to pay actual qualified adoption expenses, and the credit will be subject to a modified adjusted gross income phaseout that begins at $75,000 and ends at $115,000. See Pub. L. No. 104-188, § 1807(a), 110 Stat. 1755, 1899 (1996). For more information about the original version of the adoption credit, see Notice 97-9, 1997-1 C.B. 365 and Notice 1997-7, 1997-2 C.B. 332.

5 IRC § 23(a)(2)(B)(3). Note: For tax years (TYs) 2010 and 2011, IRC § 23 was redesignated as IRC § 36C. See Pub. L. No. 111-148, §10909(b)(1)(A), 124 Stat. 119, 1022 (2010).

6 IRC § 23(d)(3). For TYs 2010 and 2011, see IRC § 36C(d)(3).

Additionally, a child with special needs must be a citizen or resident of the United States, as defined in section 217(h)(3).[7]

Adoption assistance serves to minimize financial barriers to adoption. If a State determines a child has special needs, the State may provide financial assistance through its own programs, or by accessing federal funding, or both.[8]

In 2010 and 2011, when the adoption credit was refundable,[9] the IRS required taxpayers who were claiming the special needs adoption credit for a finalized special needs adoption to attach to their paper return both the final adoption order or decree and the State's determination of the child's special needs.[10]

The consequence of a State determination of special needs is that the adoptive parents can claim the special needs adoption credit, which permits a credit without payment of actual qualified adoption expenses. Under the IRC, however, a Native American tribal government is treated as a State only if (a) a particular Code section specifically so provides, or (b) the Code section is listed in § 7871. Neither § 23 nor § 7871 provides that a Native American tribal government is to be treated as a State for purposes of the adoption credit. Thus, a determination by a Native American tribal government that a child is a special needs child would not be sufficient to entitle the adoptive parents to a special needs adoption credit. Nor can the State where the tribe is located issue this determination, because the Indian Child Welfare Act (ICWA) grants tribes exclusive jurisdiction over custody proceedings involving Native American children who are domiciled or reside within the reservation of such tribes.[11] Consequently, the adoptive parents of a Native American child with special needs cannot claim the special needs adoption credit.[12] Current law harms Native American children with special needs by increasing the cost of their adoptions relative to similarly situated special needs children in States.

7 IRC § 217(h)(3) uses the term "United States" to include the possessions of the U.S. (*i.e.*, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, Puerto Rico, and the Virgin Islands).

8 See Children's Bureau, U.S. Dep't of Health and Human Services, Factsheet for Families, Adoption Assistance for Children Adopted From Foster Care (2011), Child Welfare Information Gateway *available at* www.childwelfare.gov/pubs/f_subsid.cfm.

9 Section 10909 of the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119, 1021 (2010) made the adoption credit refundable for 2010 and 2011 and redesignated the section as § 36C for the period the credit was refundable. See Notice 2010-66, 2010-42 I.R.B. 437.

10 The IRS provided that acceptable documentation of the State's determination of special needs includes (but is not limited to) any of the following: 1) an adoption assistance or subsidy agreement issued by the State or county; 2) certification from the State or county child welfare agency verifying that the child is approved to receive adoption assistance; and 3) certification from the State or county child welfare agency verifying that the child has special needs.

11 25 U.S.C.§ 1911(a).

12 A taxpayer who adopts a Native American child who resides or is domiciled on a reservation may be able to claim the adoption credit for qualified adoption expenses incurred, but will not be entitled to the special needs adoption credit.

EXAMPLE

The biological parents of a Native American child, who resides on the reservation, are deceased. The child's aunt and uncle, who are also members of the tribe, adopt the child. The Native American tribal government has a health agency that provides a determination letter to the adoptive parents (the aunt and uncle) stating that the child meets one of the special needs factors set out in IRC § 23. The adoptive parents pay no actual qualified adoption expenses, but submit the determination letter in support of their claim of a special needs adoption credit. The absence of a State determination of special needs (as required by § 23(d)(3)(B)), results in the disallowance of the increased special needs adoption credit.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7871(a) to include IRC § 23 in the list of Code sections for which a Native American tribal government is treated as a "State." If an Native American tribal government is treated as a State for purposes of IRC § 23, its determination that a child has special needs would enable adoptive parents to claim the special needs adoption credit, provided that the other requirements of the Internal Revenue Code are met.[13]

PRESENT LAW

The adoption credit, enacted in 1996 and effective in 1997, allowed a nonrefundable tax credit of $5,000 ($6,000 in the case of a child with special needs) for qualified adoption expenses paid or incurred in connection with the adoption of an eligible child.[14] In 2001, in an effort to encourage adoption, the maximum amount of the credit was increased to $10,000 (subject to an inflation adjustment), with the maximum being allowable for both special needs and non-special needs adoptions.[15] However, Congress remained concerned about the number of children with special needs waiting for adoption, and believed its previous attempts to provide incentives for adoption among this particular group were inadequate.[16] In 2002, Congress amended IRC § 23 to permit adoptive parents to claim a special needs adoption credit of $10,000 regardless of the amount of the expenses paid or incurred with respect to the adoption.[17]

13 As noted earlier, States may access federal funding under Title IV-E in providing adoption assistance subsidies. Title IV-E funding of Native American tribal governments may differ in some respects from Title IV-E funding of States. See Jack Trope, *Title IV-E: Helping Tribes Meet the Legal Requirements* (Mar. 2010) (working paper developed through the Indian Child Welfare Community of Practice), *available at* http://childwelfare.ncaiprc.org (last visited Dec. 21, 2012).

14 See Pub. L. No. 104-188, § 1807(a), 110 Stat. 1755, 1899 (1996).

15 Pub. L. No. 107-16, § 202, 115 Stat. 38, 47 (2001). The $10,000 amount is adjusted for inflation.

16 See H.R. Rep. No. 107-64, at 13 (2001).

17 As a result of the concern for promoting the adoption of special needs children, Congress passed the *Job Creation and Worker Assistance Act of 2002*, Pub. L. No. 107-147, 116 Stat. 21 (2002), and amended IRC § 23(a), which permitted adoptive parents, in addition to being able to claim qualified adoption expenses actually paid or incurred during a taxable year and qualified expenses paid or incurred in all prior taxable years with respect to the adoption, to also claim the difference between the actual expenses incurred and $10,000 (if any). For an in-depth discussion of the adoption credit see Most Serious Problem: *The IRS's Compliance Strategy for the Expanded Adoption Credit has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS, and Does Not Bode Well for Future Credit Administration*, *supra*.

For the parent to claim this $10,000 special needs adoption credit, the following three conditions must be satisfied:

1. A State has determined that the child cannot or should not be returned to the home of his or her parents;
2. A State has determined that the child exhibits a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical conditions, or physical, mental, or emotional handicaps) making it reasonable to conclude that placement of the child with adoptive parents requires adoption assistance; and
3. The child must be a citizen or resident of the United States.[18]

If the above requirements are met, the adoptive parent can claim the inflation-adjusted credit of $10,000 regardless of the expenses the adoptive parent actually paid or incurred. The taxpayer is treated as having paid the qualified adoption expenses with respect to the adoption during the taxable year in which the adoption becomes final, less any qualified adoption expenses previously claimed on the return.[19]

As mentioned above, the ICWA generally prevents States from issuing the required determination of special needs for a Native American child. The ICWA was passed by Congress in 1978 in an effort to address growing concerns regarding the removal of Native American children from their families and subsequent placement of those children in non-Native American homes. The ICWA grants tribes exclusive jurisdiction over custody proceedings involving Native American children residing or domiciled on the reservation, such as adoption, so that these decisions are free from States' intrusion. Further, the ICWA establishes uniform standards for placement of Native American children in foster or adoptive homes, including provisions governing parental consent and intervention procedures, tribal court jurisdiction over child placement proceedings, and non-Native American agency priority placement of Native American children with extended family members. The ICWA also authorizes federal grants to Native American tribal governments for family development programs.[20]

REASON FOR CHANGE

The adoption credit was enacted to mitigate the financial burden experienced by families adopting children as well as to reduce the number of children waiting for adoption.[21] Congress increased the amount of the credit and permitted adoptive parents to claim a special needs adoption credit of $10,000 regardless of the amount of the expenses paid or

18 Under 8 U.S.C. § 1401, Native Americans are citizens of the United States.

19 IRC § 23(a)(3).

20 25 U.S.C.§ 1911(a). See H.R. Rep. No. 1386, 95th Cong., 2d Sess. (1978). See also, S. 1214, Pub. L. No. 95-608, 92 Stat. 3069 (1978), which stated that the purpose of this act was "To establish standards for the placement of Native American children in foster or adoptive homes, to prevent the breakup of Native American families, and for other purposes."

21 H.R. Rep. No. 104-542, pt. 2, at 17 (1996), "[T]he financial costs of the adoption process should not be a barrier to adoptions. In addition, the Committee wishes to further encourage the adoption of special needs children."

incurred with respect to the adoption.[22] However, current law prevents parents who adopt a child from a Native American tribal government from claiming the credit crafted for adoptions of special needs children because the special needs determination letter provided by the tribal agency is not acceptable under the Code. Further, the ICWA generally precludes the State in which the tribe is located from issuing the determination letter for a Native American child domiciled or residing on the reservation. Therefore, individuals adopting Native American children with special needs are unfairly excluded from claiming the credit intended for special needs adoptions.

This creates a disparity in the tax law (*i.e.*, taxpayers who adopt a non-Native American special needs child can claim the credit while taxpayers who adopt a special needs child from a Native American tribe cannot) and essentially promotes adoption of one group of children over another. Congress can correct this disparity in the tax law by amending IRC § 7871(a) to refer to IRC § 23, thereby treating tribes as States for purposes of IRC § 23 so that tribal determination letters can be accepted by the IRS. This adjustment would serve the purposes of the ICWA, granting appropriate recognition to tribal determinations in this tax context.

EXPLANATION OF RECOMMENDATION

As IRC § 23 currently reads, the taxpayer must have a State determination before the taxpayer can claim that the adoptive child has special needs. A Native American tribal government is not treated as a State for purposes of IRC § 23. Thus, a determination issued by a Native American tribal government is not acceptable for the purpose of claiming the special needs adoption credit. Further, under the ICWA, the State within which the tribal agency is located is precluded from issuing such a determination for that child. Accordingly, taxpayers who adopt a child from a Native American tribal government cannot claim the credit intended for special needs adoptions. Native American children could be broadly affected, since their ethnicity or minority status might qualify them as having special needs.

Permitting a determination letter from a Native American tribal government to satisfy the requirements under IRC § 23(d)(3)(B) will make the credit for adopting a special needs child more equitable. It will also remove a disadvantage currently experienced by Native American children who are domiciled or reside on a reservation and in need of adoption. It is reasonable to permit the IRS to accept determination letters from the tribal government agency, since the tribal government is situated most favorably to issue the determination letter in a timely, efficient manner. Therefore, the IRS should have the legal authority to accept a determination letter from a Native American tribal government as sufficient substantiation, assuming all other requirements of IRC § 23 are satisfied.

22 See Pub. L. No. 107-16, 115 Stat. 38 (2001) and Pub. L. No. 107-147, 116 Stat. 21 (2002).

LR #4

Amend IRC § 7701 to Provide a Definition of "Last Known Address," and Require the IRS to Mail Duplicate Notices to Credible Alternate Addresses

PROBLEM

The IRS informs taxpayers of important statutory rights by sending notices or letters through the United States Postal Service (USPS). For example, the IRS must send to the taxpayer's "last known address" its notice of a proposed increase in tax liability which advises the taxpayer of the right to petition the Tax Court (the only prepayment judicial forum) for a review of that determination.[1] Similarly, the IRS must send to the taxpayer's "last known address" a final notice of its intent to levy which advises of the right to a pre-levy administrative hearing (referred to as a Collection Due Process or CDP hearing) and the availability of Tax Court review of the hearing outcome.[2] Often, taxpayers must claim these rights within strict time limits that begin to run when the IRS *mails* the notice or letter. So long as the IRS mails the correspondence to the taxpayer's "last known address," a term that is not defined by statute, the letter or notice is legally effective when sent.[3] The time limit begins to run on that day, regardless of whether or when the taxpayer receives the correspondence.

Despite the importance of sending correspondence to a taxpayer's last known address, the IRS defines that term with reference to mid-20th century technology. It has failed to keep up with the information age, where the IRS could readily consult available data when it learns that its own records do not reflect a taxpayer's current address, either because mail sent there is returned as undeliverable or the IRS acquires this knowledge another way. Only some parts of the IRS react to undelivered mail by venturing beyond IRS databases and consulting other sources of information about taxpayers' current addresses, such as motor vehicle registrations or real property records.

In view of the importance of sending mail to a taxpayer's last known address and the availability of third-party data, the Court of Appeals for the Fifth Circuit has held the IRS accountable for doing more than looking within its own databases to identify a taxpayer's correct address once it learns the address in its records is incorrect.[4] However, the IRS has not adopted the approach mandated by the Fifth Circuit. For essential notices that advise taxpayers of fundamental rights, such as the statutory notice of deficiency, it does not

1 Taxpayers have the right under Internal Revenue Code (IRC) § 6213(a) to petition the Tax Court for review of a statutory notice of deficiency.

2 Taxpayers have the right to an administrative hearing under IRC §§ 6320 and 6330 (the outcome of which is appealable to the Tax Court under IRC § 6330(d)) when the IRS proposes to levy or has filed a lien.

3 *See, e.g.*, IRC § 6212(b)(1), providing that "a notice of a deficiency ...if mailed to the taxpayer at his last known address, shall be sufficient;" *Cool Fuel, Inc. v. Connett*, 685 F.2d 309 at 312 (9th Cir. 1982); (noting goal of IRC § 6212 to provide actual notice, but proper mailing to last known address is sufficient); *Rappaport v. United States*, 583 F.2d 298, 301 (7th Cir. 1978) (finding proper mailing to last known address is sufficient notice). An array of IRC provisions require the IRS to send notices to taxpayers at their "last known address." Rev. Proc. 2010-16, 2010-19 I.R.B. 664, explaining how the IRS is informed of a change of address, identifies 20 IRC sections that require notices and documents to be sent to the taxpayer's "last known address."

4 *Mulder v. Comm'r*, 855 F.2d 208 (5th Cir.1988); *Terrell v. Comm'r*, 625 F.3d 254 (5th Cir. 2010).

search beyond its own databases for a taxpayer's correct address, even when it learns that that address is incorrect. By wearing these "blinders" the IRS may "deprive [taxpayers] ... of their only opportunity for a prepayment hearing to litigate their case."[5] Taxpayers who can seek review by the Court of Appeals Fifth Circuit may be able to avoid this outcome, but others may not be so fortunate. Thus, similarly situated taxpayers may be treated differently as they seek to exercise their fundamental rights.

IRS or Treasury guidance could resolve this issue, but has not been forthcoming, and the disinclination to act means that taxpayers are being harmed even as we write. Given the availability of technology and the centrality of "last known address" to fundamental rights that preserve the perception (and actuality) of fairness in our tax system, the small burden of requiring reliable database investigation is more than outweighed by taxpayers' and the government's interest in procedural fairness. Congressional action would spur the IRS to expand the measures it takes in the 21st century to identify taxpayers' last known addresses.

EXAMPLE

In 2011, M filed her 2010 return and then moved without notifying the Postal Service or the IRS of her change of address. In 2012, the IRS mailed M a notice informing her that her 2010 return had been selected for audit and requesting documentation in support of the deductions she claimed. The IRS sent the notice to M's old address, which was the address shown on her most recent return (the one for 2010), and the notice was returned to the IRS as undeliverable with no corrections marked on the address information.

The IRS searched its databases for a more recent address but did nothing further to ascertain the correct one. It sent M a second audit notice at her old address, which was also returned as undeliverable with no correcting information. Again, the IRS did not attempt to ascertain M's correct address by looking outside its own databases. Hearing nothing from M, the IRS concluded its audit and issued a statutory notice of deficiency, proposing to assess additional tax against M and informing her she had 90 days to petition the Tax Court for review.[6] It sent the notice of deficiency to M at her old address, she never received it, and the IRS assessed the additional tax by default.[7]

If M challenges the validity of the notice of deficiency in a Tax Court proceeding, and an appeal from the Tax Court's decision would be to the Court of Appeals for the Fifth Circuit, the Tax Court will apply the holdings in the *Mulder* and *Terrell* decisions that the notice of deficiency, and consequently the assessment, is invalid due to the IRS's failure to try to

5 *Keeton v. Comm'r*, 74 T.C. 377, 383-4.

6 Under IRC § 6213(a) the IRS must generally mail a taxpayer a statutory notice before it can assess a tax deficiency.

7 IRC § 6213(c) provides that if a taxpayer does not timely petition the Tax Court for review of a notice of deficiency, the IRS must assess the additional tax.

correct what it knew to be an incorrect address.[8] The period of limitations for assessing M's liability for 2010 will very likely have expired; if so, the IRS will not be able to proceed, even if it is correct on the merits. In an identical case appealable to a different Court of Appeals, the Tax Court may hold that the notice of deficiency was effective when it was mailed and the assessment was therefore valid.

RECOMMENDATION

The National Taxpayer Advocate reiterates her recommendation that Congress amend IRC § 7701 to add a definition of "last known address" that incorporates case law, including the Fifth Circuit's holdings in the *Mulder* and *Terrell* cases, and current regulations. She also reiterates her recommendation that Congress direct the Secretary of Treasury to:

1. Develop procedures for checking third-party databases for credible alternate addresses prior to sending notices that establish legal rights and obligations (*i.e.*, Statutory Notices of Deficiency, Collection Due Process notices, notices of federal tax lien, etc.).
2. When the IRS learns that its records do not contain a taxpayer's correct address, and the taxpayer has a credible alternate address, require the IRS to mail the notice simultaneously to the last known and credible alternate addresses (as defined by the Secretary).[9]

CURRENT LAW

The IRS is required to send at least 20 notices or documents contemplated in various Internal Revenue Code provisions to a taxpayer's last known address.[10] None of these provisions includes a definition of "last known address" (nor is such a definition found elsewhere in the IRC), yet several of them provide for important statutory rights that must be claimed within time limits triggered by the IRS's mailing of the notice to the "last known address." For example:

- IRC § 6213(a) generally requires the IRS to mail to a taxpayer a statutory notice of deficiency before it can assess a tax deficiency, and IRC § 6213(b) provides that sending the

8 Pursuant to the rule in *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd* 445 F.2d 985 (10th Cir. 1971), the Tax Court will defer to a Court of Appeals decision which is squarely in point where appeal from the Tax Court decision lies to that Court of Appeal.

9 National Taxpayer Advocate 2011 Annual Report to Congress 493 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2008 Annual Report to Congress 449 (Legislative Recommendation: *Mailing Duplicate Notices to Credible Alternate Addresses*).

10 These include IRC §§ 982(c)(1) (formal document request for the production of foreign-based documentation); 6015(e) (notice of final determination regarding spousal relief); 6110(f)(3)(B) (notification of disclosure proceedings); 6110(f)(4)(B) (notification of disclosure proceedings); 6212(b) (notice of deficiency); 6245(b)(1) (notice of partnership adjustment for electing large partnerships); 6303(a) (notice and demand for tax); 6320(a)(2)(C) (notice and opportunity for hearing upon filing of notice of lien); 6325(f)(2)(A) (notice of revocation of certificate of release or nonattachment of a lien); 6330(a)(2)(C) (notice and opportunity for hearing before levy); 6331(d)(2)(C) (notice of intention to levy); 6332(b)(1) (copy of notice of levy with respect to a life insurance or endowment contract); 6335(a) and (b) (notices of seizure and sale); 6404(h) (notice with respect to interest abatement); 6901(g) (notice of liability in transferee cases); 7430(f)(2) (action for reasonable administrative costs); 7436 (employment status determinations); 7603(b)(1) (summons by mail to third-party record keeper);7609(a)(2) (notice of third-party summons); and 7623(b)(4) (Whistleblower award determinations). *See* Rev. Proc. 2010-16, 2010-19 I.R.B. 664.

notice to the taxpayer's last known address is sufficient. Taxpayers have 90 days after the IRS mails the notice (150 days, if the notice was addressed to a taxpayer outside the United States) to file a Tax Court petition.[11] If the taxpayer does not respond to a valid statutory notice of deficiency, the IRS must assess the tax and the taxpayer can no longer obtain judicial review without first paying the tax.[12]

- IRC § 6331(d) requires the IRS to give taxpayers 30 days notice that it intends to levy on their property; IRC § 6330 (a) requires the IRS to further notify taxpayers of their right to challenge the levy action in a CDP hearing.[13] Similarly, IRC § 6320 requires the IRS to notify taxpayers that it has placed a lien on their property, and of their right to challenge the lien in a CDP hearing. A taxpayer requesting a CDP hearing must do so within 30 days after the IRS mails the IRC § 6330 or § 6320 notice to the taxpayer's last known address.[14] If the IRS then determines to proceed with the collection action, the taxpayer has the right to judicial review of the determination if he or she petitions the Tax Court within 30 days after the IRS mails the notice of its determination.[15] A taxpayer who does not respond to a valid IRC § 6330 or § 6320 notice loses not only the right to an administrative hearing, but also to pre-enforcement judicial review.
- IRC § 6015(e) provides that when the IRS mails to a taxpayer at his or her last known address its determination regarding the taxpayer's request for innocent spouse relief, the taxpayer has 90 days to petition the Tax Court for review of that determination. A taxpayer who does not respond to a valid notice of determination under IRC § 6015(e) loses the right to prepayment judicial review of a denial of innocent spouse relief.

Judicial interpretation of "last known address" prior to Treasury Regulation § 301.6212-2

Prior to January 2001, when a Treasury regulation[16] defined "last known address," case law established basic principles. The Tax Court summarized the general rules in *Keeton v. Commissioner* as follows:

> For the purposes of section 6212(b), a taxpayer's last known address must be determined by a consideration of all relevant circumstances; it is the address which, in light of circumstances, the respondent reasonably believes the taxpayer wishes to have the respondent use in sending mail to him. *O'Brien v. Commissioner*, *supra* at 548; *Lifter v. Commissioner*, 59 T.C. 818, 821 (1973). Normally, a taxpayer's "last known address" is that shown on his tax returns filed with respondent. *O'Brien*

11 IRC § 6213(a). Congress rejected a bill that would have required the taxpayer to have actual notice of the proposed deficiency because of the burden it would have imposed on the Commissioner. See Revenue Act of 1924, ch. 234, sec. 274(a) 43 Stat. 253, 297, 65 Cong. Rec. 2969-70 (1924) (proposed amendment by Rep. Allen).

12 IRC § 6213(c) provides that if a taxpayer does not timely petition the Tax Court for review of a notice of deficiency, the IRS must assess the additional tax.

13 Sections 6330 and 6320 were added by the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3401(a), (b), 112 Stat. at 746-49. Prior to its enactment, any judicial review was only available post-collection.

14 IRC § 6330(a)(2), (3), § 6320(a)(2), (3).

15 IRC § 6330(d); Treas. Reg. § 301.6330-1(f); *Weber v. Comm'r*, 122 T.C. 258 (2004).

16 Treas. Reg. § 301.6212-2, T.D. 8939, 66 Fed.Reg. 2817-01 (Jan. 12, 2001).

> *v. Commissioner, supra* at 549; *Cohen v. United States*, 297 F.2d 760, 773 (9th Cir. 1962), cert. denied 369 U.S. 865 (1962). Respondent is required, however, to use a different address if he learns or is advised by the taxpayers that the taxpayer has changed his address. *DiViaio v. Commissioner*, 539 F.2d 231 (D.C. Cir. 1976), *revg.* an order of dismissal of this Court; Cohen v. United States, *supra* at 773; *O'Brien v. Commissioner, supra* at 549; *Alta Sierra Vista, Inc. v. Commissioner*, 62 T.C. 367, 374-375 (1974), affd. in an unpublished opinion 538 F.2d 334 (9th Cir. 1976). Once respondent learns that a taxpayer is residing at an address other than the one shown on the return, he must exercise reasonable care and diligence in ascertaining and mailing the notice of deficiency to the correct address. *Johnson v. Commissioner*, 611 F.2d 1015, 1021 (5th Cir. 1980), r*evg.* a Memorandum Opinion of this Court; *Alta Sierra Vista, Inc. v. Commissioner, supra* at 374; *Maxfield v. Commissioner*, 153 F.2d 325, 326 (9th Cir. 1946), *revg.* an order of dismissal of this Court; *United States v. Eisenhardt*, 437 F. Supp. 247 (D. Md. 1977).
>
> In ascertaining whether respondent has mailed a notice to a taxpayer's "last known address" as required by section 6212, the relevant inquiry pertains to the Commissioner's knowledge rather than what may, in fact, be the taxpayer's most current address. *Alta Sierra Vista, Inc. v. Commissioner, supra* at 374; *Cohen v. United States, supra* at 773.[17]

Keeton concerned spouses who had been convicted of tax evasion. The IRS initiated the proceedings that culminated in their trial and conviction, and was inextricably involved in the criminal case. As a result of the convictions, the husband was incarcerated in a federal penitentiary and the wife moved, subject to the jurisdiction of federal probation authorities, to a new address near the penitentiary. The Tax Court found the IRS knew the couple no longer resided at their former address when it mailed the notice of deficiency to them there. The court held,

> We will not allow respondent to come into this Court wearing blinders and deprive petitioners, in these circumstances, of their only opportunity for a prepayment hearing to litigate their case. See *Lifter v. Commissioner, supra* at 820; *Berger v. Commissioner*, 404 F.2d 668 (3d Cir. 1968), affg. 48 T.C. 848 (1967), cert. denied 395 U.S. 905 (1969); *Johnson v. Commissioner, supra* at 1018.[18]

Other cases decided before the effective date of the Treasury regulations under IRC § 6212 examined whether taxpayer communications to the IRS were sufficient to advise the IRS that the taxpayer had changed his address. In *Abeles v. Commissioner*, for example, the Tax Court reconsidered its position that IRS was entitled to rely on the address on the

17 *Keeton v. Comm'r*, 74 T.C. 377, 381-2 (1980).

18 *Id*. at 383-4. The court noted that in other cases in which a taxpayer was incarcerated for non-tax crimes, a notice of deficiency sent to his previous address was not mailed to a taxpayer's "last known address."

taxpayer's return *for the year under audit* as showing the taxpayer's "last known address."[19] In view of advances in technology that permitted the IRS to ascertain the address shown on the taxpayer's most recently filed return, the court announced that a taxpayer's last known address is that shown on the most recently filed return, unless the IRS has been given clear and concise notification of a different address.[20]

The Tax Court also decided *Mulder v. Commissioner*, in which there was no notification from the taxpayer of a change of address, yet the IRS was aware that the address where it sent the notice of deficiency was not correct because mail previously sent to that address had been returned as undeliverable.[21] However, the Tax Court found the notice of deficiency was valid and dismissed the taxpayer's petition for lack of jurisdiction. Among other things, the court found that a search of the IRS's own databases would not have revealed a more recent address. The Court of Appeals for the Fifth Circuit reversed the Tax Court, finding that the record did not support the IRS's claim that it had searched its own databases for a more recent address. However, whether a database search had occurred or not, the court found,

> Under the circumstances of this case, given the facts that two letters posted shortly before the notice of deficiency were returned undelivered, and that the notice of deficiency was neither delivered nor returned, we are not persuaded that the IRS exercised due diligence in sending the notice to Mulder's last known address. More should have been done. At the very least, the tax-preparer should have been contacted.[22]

IRS and Treasury interpretation of "last known address"

Against this background of case law, in 1990 the IRS issued Revenue Procedure 90-18, providing guidance on how taxpayers could inform the IRS of a change of address.[23] The IRS described the law pertaining to "last known address," however, as follows: "The phrase 'last known address' does not necessarily mean the taxpayer's actual address but instead means the last address that *the taxpayer makes known to the Service*." (emphasis added).[24]

The revenue procedure does not contain any reference to the requirement that the IRS exercise care and due diligence, the relevance of the IRS's knowledge when it sends a notice of deficiency, or the necessity to consider all the facts and circumstances in determining a taxpayer's "last known address." The guidance incorporates the rule set forth in *Abeles* that a taxpayer's "last known address" is the one shown on the most recently filed return, absent clear and concise notification of a different address. Among other things, the guidance also

19 *Abeles v. Comm'r*, 91 T.C. 1019 (1988).

20 *Abeles v. Comm'r*, 91 T.C. 1035 (1988).

21 *Mulder v. Comm'r*, T. C. Memo. 1987-363.

22 *Mulder v. Comm'r*, 855 F.2d 208 at 212 (5th Cir.1988) *rev'g and remanding* T.C. Memo. 1987-363.

23 Rev. Proc. 90-18, 1990-1 C.B. 491.

24 *Id*. at § 3.02.

advised taxpayers that written notification of a change of address was required and that the IRS was developing a new Form 8822, *Change of Address*, for this purpose. Notifying the USPS of a change in address would not suffice.[25] The guidance concluded, "[t]his revenue procedure does not require the Service to send notices to an address furnished by the taxpayer when it is determined that a taxpayer cannot actually be contacted or located at that address."[26]

In January 2001, the Treasury released regulation § 301.6212-2, defining "last known address."[27] The regulation, which is still in effect, allows the IRS to access USPS change-of-address information and update its records accordingly, and provides that change-of-address information a taxpayer provides to a third party is otherwise not clear and concise notification to the IRS of a different address. The relevant part of the regulation is:

> **§ 301.6212–2 Definition of last known address.**
>
> **(a) General rule.** Except as provided in paragraph (b)(2) of this section [referencing an exception for addresses obtained from USPS], a taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed Federal tax return, unless the Internal Revenue Service (IRS) is given clear and concise notification of a different address. Further information on what constitutes clear and concise notification of a different address and a properly processed Federal tax return can be found in Rev. Proc. 90–18 (1990–1 C.B. 491) or in procedures subsequently prescribed by the Commissioner.
>
> **(b) Address obtained from third party—(1) In general.** Except as provided in paragraph (b)(2) of this section [referencing an exception for addresses obtained from USPS], change of address information that a taxpayer provides to a third party, such as a payor or another government agency, is not clear and concise notification of a different address for purposes of determining a last known address under this section.

Like the IRS guidance it references, the Treasury regulation does not contain any discussion of the IRS's duty to use diligence in ascertaining a taxpayer's last known address once it is on notice that the address in its records is no longer valid. Consequently, it neither prohibits the IRS from consulting nor requires it to consult third-party sources or mail a notice to the taxpayer at an address it obtains from a third party other than USPS. Since 2001, the IRS has recognized that, at least with respect to some correspondence returned as undeliverable, notification from USPS that an address is not correct constitutes official notification to the IRS that a taxpayer's address has changed, but only if USPS also provided the correct

25 Rev. Proc. 90-18, 1990-1 C.B. 491 § 4.02, 06..

26 *Id*. at § 6.03.

27 Treas. Reg. § 301.6212-2, T.D. 8939, 66 Fed. Reg.2817-01 (Jan. 12, 2001). The regulation was preceded by a notice of public rulemaking (64 Fed. Reg. 63768, Nov. 22, 1999), but no public hearing was requested or held. Three written comments were received. The regulation applies to determine "last known address" wherever that term is used in the Code or regulations. Treas. Reg. § 301.6212-2(c).

address.[28] The IRS has never recognized a duty to investigate, but only to change an address to one USPS provides. The IRS Office of Chief Counsel has concluded that the IRS is under no obligation to look outside its own records for a taxpayer's address.[29] The National Taxpayer Advocate's position is that once the IRS is on notice that an address in its records is not correct, where significant taxpayer rights are at stake it should take affirmative steps to ascertain the taxpayer's correct address if USPS has not provided one.

As a matter of internal procedure, the IRS does obtain a "potential current" address from a third party when certain notices are returned as undeliverable.[30] However, it does not then resend the notice to the "potential current" address, but issues another letter, referred to as the "Are You There" letter, asking the taxpayer to confirm the address, sign, and return the letter, which can take 100 days or more.[31] IRS field examiners, who meet with taxpayers by telephone or in person, write to taxpayers to schedule and confirm appointments.[32] If the taxpayer does not respond to the initial contact letter and is no longer at the address shown in IRS records, the examiner must take specific steps to locate the taxpayer and document that those steps were taken.[33] In addition to researching IRS databases and asset locator services and searching the Internet, the measures include contacting the taxpayer's employer, return preparer, representative, or other third parties such as banks, brokerage houses, mortgage companies and other third party payor(s), if known. If the examiner finds the taxpayer's correct address, the correspondence is re-addressed and re-mailed.[34]

Judicial interpretation of "last known address" after the effective date of Treasury regulation § 301.6212-2

Following the issuance of the Treasury regulation, courts continued to interpret various statutes that require the IRS to send notices to a taxpayer's "last known address." As before the effective date of the Treasury regulation, the cases reiterated the requirement that the IRS use due diligence based on information it knew or should have known to ascertain a taxpayer's last known address. For example, in *Downing v. Commissioner*, the Tax Court

28 Rev. Proc. 90-18 was superseded by new guidance in 2001, Rev. Proc. 2001-18, 2001-8 I.R.B. 708. The 2001 guidance, in §§ 5.04 and 5.05, provided that correspondence soliciting or requiring a response by the taxpayer that is returned to the IRS with corrections marked on the taxpayer's address information will be considered clear and concise written notification of a change of address, and described the circumstances under which taxpayers could provide clear and concise oral notification of a change of address. The 2001 guidance was superseded in 2010 by Rev. Proc. 2010-16, 2010-19 I.R.B. 664, but these provisions remained intact. The 2010 guidance also contains no reference to the IRS's obligation to use due diligence to ascertain a taxpayer's "last known address."

29 National Office Program Manager Technical Advice, PMTA-2008-1634 (Jan. 9, 2008).

30 The Address Research (ADR) system is an IRS system that uses internal databases and Accurint (a contracted asset locator service that supplies "potential current" address information for taxpayers, upon request from the IRS) to search for potential new taxpayer addresses. Internal Revenue Manual (IRM) 5.19.7.5 (Sept. 30, 2010). However, not all notices are processed through the ADR system when mail is returned as undeliverable. For example, Automated Collection System Letter 11, which advises taxpayers of a final notice of intent to levy and their right to a hearing, is not processed through the ADR system. IRM 5.19.7.5.3 (Sept. 30, 2010).

31 For a more complete description of this procedure and the problem of undelivered mail, see National Taxpayer Advocate 2010 Annual Report to Congress 221 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*); National Taxpayer Advocate 2008 Annual Report to Congress 449 (Legislative Recommendation: *Mailing Duplicate Notices to Credible Alternate Addresses*).

32 IRM 4.10.2.7.3 (Aug. 1, 2007).

33 IRM 4.10.2.7.2.2 (Apr. 2, 2010).

34 IRM 4.10.2.7.2.1 (Apr. 2, 2010).

held that a Form 2848, *Power of Attorney*, received after the most recently filed return had been filed but before it had been processed, was sufficient to provide clear and concise notification of a change of address.[35] A notice of determination sent to the address on the taxpayer's return was invalid because it was not sent to the "last known address" as required by IRC § 6330, which by then cross-referenced Treasury regulation § 301.6212-2. The court reiterated:

> The relevant question is not whether the IRS received the change of address notification before or after the last-filed return was processed. Rather, "what is of significance is what respondent knew at the time the * * * notice was issued * * *, and attributing to respondent information which respondent knows, or should know, with respect to a taxpayer's last known address, through the use of its computer system." *Abeles v. Commissioner,* 91 T.C. 1019, 1035 (1988). If the IRS has become aware of a change of address, it may not rely on the address listed on the last-filed return but must exercise "reasonable diligence in ascertaining the taxpayer's correct address."[36]

However, just as it had in *Mulder*, the Tax Court decided that the IRS was not obliged to take further action beyond consulting its own databases when mail sent to the address shown on a taxpayer's most recently filed return was returned as undeliverable. In *Terrell v. Commissioner*, the IRS sent the taxpayer a final notice of determination denying her request for relief under IRC § 6015.[37] The IRS sent the notice to the address the taxpayer used on Form 8858, *Request for Innocent Spouse Relief*, but because the taxpayer had moved after requesting relief, the notice was returned as undeliverable. Two previous pieces of correspondence sent to that address had also been returned as undeliverable. However, after the IRS sent the final notice of determination, but before it was returned as undeliverable, the taxpayer filed a return showing her current address. The IRS resent the final notice of determination, which the taxpayer then received. The taxpayer petitioned the Tax Court within 90 days of the date the final notice of determination had been sent the second time, but beyond 90 days after the date it was sent the first time. The IRS argued that the court lacked jurisdiction over the claim because the taxpayer had not timely filed her petition.

The Tax Court found the IRS had exercised due diligence in determining the taxpayer's last known address when it sent the notice of determination the first time, but just as it had in the *Mulder* case, the Court of Appeals for the Fifth Circuit reversed the Tax Court's decision in *Terrell*.[38] Finding that the IRS did nothing to ascertain the taxpayer's correct address

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35 *Downing v. Comm'r*, T.C. Memo. 2007-291. The most recent IRS guidance, Rev. Proc. 2010-16, 2010-19 I.R.B. 664, §5.04(4) provides that a Form 2848, *Power of Attorney*, will not be used to update the taxpayer's address of record.

36 *Id.*, slip op. at 20.

37 T.C. Docket No. 15894-07 (July 30, 2009) (order dismissing for lack of jurisdiction). Under IRC § 6015(e)(1)(A)(ii), a taxpayer may petition the Tax Court for review of the IRS's denial of innocent spouse relief if he or she does so within 90 days after the IRS sends a notice of determination to the taxpayer's "last known address."

38 *Terrell v. Comm'r*, 625 F.3d 254 (5th Cir. 2010), *rev'g and remanding* T.C. Docket No. 15894-07 (July 30, 2009) (order dismissing for lack of jurisdiction).

once it knew the address in its records was incorrect, the court held that the IRS did not exercise reasonable diligence and the notice of determination was null and void the first time it was sent. However, it was legally effective to commence the 90-day period for petitioning the Tax Court the second time it was sent and finally received by the taxpayer. Because the taxpayer filed her petition within the statutory period, the Tax Court had jurisdiction to hear her claim.

REASONS FOR CHANGE

The Code provides no statutory definition of "last known address," and the Treasury regulation definition does not completely reflect the case law as it existed before its effective date, nor developments since then. The recommendation would relieve the burden on taxpayers who do not receive notifications of important statutory rights, and the clarification would reduce the risk to the government that an ineffective notice of deficiency will later bar it from assessing or collecting tax that would otherwise be due. The change would apply to taxpayers for whom the IRS has been placed on notice — either because USPS has returned correspondence as undeliverable or by some other means — that the address has changed. As the Court of Appeals for the Fifth Circuit held, once the IRS is on notice, it has a duty to investigate. In the 21st century, that duty extends beyond investigating its own databases. Given the availability of technology and the centrality of "last known address" to fundamental rights that preserve the perception (and actuality) of fairness in our tax system, the small burden of requiring reliable database investigation is more than outweighed by taxpayers' and the government's interest in procedural fairness. The recommendation would also avert a potential conflict among the Courts of Appeal and help ensure that similarly situated taxpayers receive similar treatment.

EXPLANATION OF RECOMMENDATION

IRC § 7701 contains definitions of terms that appear throughout the Code and would be the logical section in which to include a definition of "last known address." The new definition would incorporate and update key concepts from Treasury Regulation § 301.6212-2, and would reflect case law, including the Fifth Circuit's holdings in the *Mulder* and *Terrell* cases. Thus, the definition would clarify that the IRS must use due diligence to ascertain a taxpayer's correct address once it is on notice that the address its files is no longer valid. Due diligence in these circumstances requires the IRS to look beyond its own databases to ascertain the taxpayer's correct address. Because the IRS needs guidance that will allow it to meet its obligations, Congress would direct the Secretary of Treasury to

1. Develop procedures for checking third-party databases for credible alternate addresses whenever mail is returned as undeliverable, and prior to sending notices that establish legal rights and obligations (*i.e.*, Statutory Notices of Deficiency, Collection Due Process notices, notices of federal tax lien, etc.) when the IRS is aware that its records do not reflect the taxpayer's current address; and

2. When the taxpayer has a credible alternate address, require the IRS to mail the notice simultaneously to the last known and credible alternate addresses (as defined by the Secretary).

LR #5

Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences

PROBLEM

Taxpayer protections on lien foreclosure suits against principal residences are inadequate. After a taxpayer fails to pay any tax, the federal tax lien arises by operation of law.[1] The IRS may generally commence an administrative seizure when it notifies a taxpayer of the opportunity to be heard in a Collection Due Process (CDP) hearing.[2] After the taxpayer's hearing (or failure to respond), the IRS may seize the taxpayer's property, subject to protections provided by the Internal Revenue Code. A taxpayer's principal residence is generally protected from seizure if:

- The tax liability is $5,000 or less;
- The taxpayer owns insufficient equity in the property;
- The taxpayer will suffer an economic hardship from the seizure;
- An installment agreement (IA) or offer in compromise (OIC) is pending, or if rejected, for 30 days after rejection or during any appeal of the rejection;
- An IA is in effect, or if terminated, for 30 days after the termination or during any appeal of the termination;
- An IRS Area Director does not approve the seizure; or
- A United States District Court judge or magistrate finds the requirements of any applicable law or administrative procedures have not been met, the tax liability is not owed, or the taxpayer's other assets are sufficient for the collection of the debt.[3]

Yet after the IRS files a Notice of Federal Tax Lien (NFTL) in the public records and offers a CDP hearing to the taxpayer, the IRS may request that the U.S. Attorney General (AG) direct the filing of a suit to foreclose the tax lien and sell the taxpayer's principal residence, without reference to the protections applicable to seizures.[4]

IRS procedures recommend that employees request lien foreclosure suits, in lieu of approvals for seizures of principal residences, for taxpayers' residences with "issues related to ownership, nominee situations, collection statute concerns ..., or other items."[5] Ownership

1 Internal Revenue Code (IRC) § 6321.

2 IRC §§ 6330(a)(3) and 6331(a).

3 IRC §§ 6331(k), 6334(a)(13), 6334(e) and 6343(a)(1)(D); Treas. Reg. § 301.6334-1(d)(1). Internal Revenue Manual (IRM) 5.17.3.4.5, *Seizure of a Residence/Principal Residence* (Jan. 7, 2011). IRM 5.10.1.2, *List of Prohibited Seizures* (Dec. 13, 2005).

4 IRC § 7403.

5 IRM 5.10.2.18, *Judicial Approval for Principal Residence Seizures* (July 3, 2009). Collection statute concerns generally develop from collection statutes expiring in one year or less. Collection statute refers to the statutory period for IRS collections (generally ten years) provided by IRC § 6502(a), plus suspensions and extensions provided by law. Nominee situations generally arise when another party owns the property but the taxpayer has the exclusive use and enjoyment of the property. IRM 5.17.2.5.7, Property Held By Third Parties (Mar. 27, 2012); *Oxford Capital Corp. v. United States*, 211 F.3d 280, 284 (5th Cir. 2000).

issues for a principal residence generally arise when another party, such as a non-liable spouse, claims an interest in the property.[6] In these situations, the U.S. District Court may order the sale of the principal residence of a taxpayer, who may be suffering an economic hardship, without regard to the significant taxpayer protections applicable to the IRS's seizure power.

Whether by seizure or foreclosure, the taking of principal residences effectively deprives taxpayers of their homes and the financial resources to acquire new ones. Inadequate taxpayer protections respecting the IRS's ability to request foreclosure may disrupt the taxpayer's livelihood and cause unnecessary harm to his or her family members, the very injuries Congress sought to prevent when the IRS seizes principal residences.

EXAMPLE

A married taxpayer files her tax returns separately from her husband. Both are employed and jointly own a home, which is valued at $300,000. In 2001 and 2002, the taxpayer earns substantial income. In 2003, she files her 2001 return late and her 2002 return timely, showing $20,000 underpayments for each year. The taxpayer miscalculates her estimated taxes; a higher bracket in fact applies. When she discovers the underpayments, she enters into an installment agreement to pay the taxes.

In September 2005, a revenue officer (RO) contacts the taxpayer, because the IRS terminated her IA after she missed two installments. The RO files an NFTL, and sends her Letter 3172, *Notice of Federal Tax Lien Filing and your Rights to a Hearing Under IRC 6320*. The RO also sends the taxpayer Letter 1058, *Notice of Intent to Levy and Notice of Your Right to a Hearing*, notifying her that the IRS proposes to seize her property, and she requests a hearing for the lien and levy action. Because her husband has developed Parkinson's disease, the taxpayer's income is insufficient to pay the couple's basic living expenses. The hearing officer determines that her account should be placed in currently not collectible (CNC) status.

In September 2012, the RO contacts the taxpayer for collection. She is in current compliance, although her 2001 and 2002 tax liability, including interest and penalties, has grown to approximately $50,000. The RO suggests that the taxpayer mortgage her home to pay her tax debts. She explains that her husband no longer works, and she is unable to pay the additional monthly payments for a mortgage. Further, their home has been specially modified to accommodate her husband's condition. The RO proposes to foreclose the IRS's lien against the taxpayer's residence, because there is less than one year left in the statutory period for collection. He receives Area Director approval of the foreclosure and refers the suit to the AG.

6 IRM 5.17.2.5.2, *Real Property* (Mar. 27, 2012).

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7403 to preclude an IRS employee from requesting that the AG direct the filing of a civil action to foreclose the federal tax lien against a taxpayer's principal residence in U.S. District Court, unless the IRS employee has received executive-level approval after determining that:

- The taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, including the expenses of the proceedings; and
- The foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer.

PRESENT LAW

Upon assessment of a tax liability, notice to the taxpayer, demand for payment, and the taxpayer's neglect or refusal to pay, a lien in favor of the United States attaches to the taxpayer's property or rights to property.[7] The lien attaches to all property, which includes property held by spouses as tenants by the entirety.[8] In the absence of jeopardy, 30 days after the IRS furnishes a notice of intent to levy to the taxpayer and provides an opportunity for a CDP hearing, the IRS may seize the taxpayer's property or rights to property (except property exempt under IRC § 6334).[9] As soon as practicable after seizure, the IRS must provide written notice to the taxpayer specifying the amount owed, a description of the property seized, and the time, place, conditions, and manner of the sale.[10]

The IRS must generally consider the type of property, collection alternatives, and the financial condition of the taxpayer before collecting by seizure. The Taxpayer Bill of Rights I (TBOR I), enacted in 1988, requires the IRS to release any levy, including seizures, upon a taxpayer's property or rights to property if the IRS determines the seizure is creating an economic hardship due to the financial condition of the taxpayer (*i.e.*, he or she cannot

7 IRC § 6321. IRC §§ 6324, 6324A and 6324B provide for special liens in favor of the U.S. to collect certain unpaid estate and gift taxes. For purposes of this legislative recommendation, the discussion is limited to the general statutory tax lien under IRC § 6321.

8 *United States v. Craft*, 535 U.S. 274, 281-288 (2002). Like joint tenants, tenants by the entirety enjoy the right of survivorship. Unlike joint tenancies, tenancies by the entirety cannot easily be severed unilaterally. Typically, severance requires the consent of both spouses, or the ending of the marriage in divorce.

9 IRC § 6331(a). The IRS's power to seize a taxpayer's property is also known as a levy. Most levies involve the taking of money. However, seizures generally involve the taking of property and selling it pursuant to IRC § 6335. Seizure action is usually the last option in the collection process. IRM 1.2.14.1.8, *Policy Statement* 5-34 (May 28, 1999). IRC § 6330 generally provides the right to a CDP hearing before levy if the taxpayer requests the hearing no later than 30 days after receiving the notice of intent to levy, unless the collection of tax is in jeopardy. The IRS does not need to identify any specific property it intends to levy or seize in the CDP notice. *See* IRM 5.11.1.2.2, *Satisfying the Notice Requirements* (Dec. 11, 2009).

10 IRC § 6335. The IRS also places the notice of sale in some newspaper published or generally circulated within the county where the seizure was made, and posts this notice in the local post office and at least two other public places.

meet basic living expenses).[11] Where collection would create an economic hardship, the IRS also may forego seizure to collect a taxpayer's account and place it in CNC status.[12]

TBOR I also provides for district director or assistant district director approval or a finding that the collection of tax is in jeopardy before the IRS may seize a principal residence.[13] A taxpayer's principal residence includes the principal residence of the taxpayer, the taxpayer's spouse, former spouse, or minor child.[14] The IRS Restructuring and Reform Act of 1998 (RRA 98) amended TBOR I to exempt a principal residence (within the meaning of IRC § 121) from seizure, unless a judge or magistrate of a U.S. District Court approves the seizure under IRC § 6334(e).[15] The judge or magistrate may not approve the seizure unless he or she determines the taxpayer's other assets subject to collection are insufficient to pay the amount due, including the expenses of the proceedings.[16] Further, if the tax liability does not exceed $5,000, the IRS may not seize any property used as a residence by the taxpayer or other real property owned by the taxpayer (other than rental property) used by any other individual as a residence.[17]

After the lien arises but before the IRS forecloses, the IRS generally files an NFTL to protect its interests from any purchaser, security interest holder, mechanic's lienor, or judgment lien creditor.[18] After the filing, the IRS must provide the taxpayer an opportunity to be heard by requesting a CDP hearing within 30 days of the period ending five business days after the filing.[19] Whether or not the IRS has seized property, the IRS may request that the AG or his delegate direct a civil action to be filed in a U.S. District Court to enforce the federal tax lien to collect the liability, or to subject any property in which the taxpayer has any right, title, or interest, to the payment of such liability.[20] When requesting lien foreclosure, the IRS also may request that the AG seek a judgment against the taxpayer for any unpaid

11 This section of the Taxpayer Bill of Rights I was enacted as part of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, § 6236(f), 102 Stat. 3740 (codified as IRC § 6343(a)). Treas. Reg. § 301.6343-1(b)(4) defines economic hardship.

12 IRM 5.16.1.1 (May 22, 2012). *See* IRM 5.10.3.5, *Seizing the Property* (Jan. 22, 2008), if the taxpayer claims a hardship situation, the revenue officer should determine, based on the particular circumstances if the actual seizure action should be discontinued.

13 TAMRA, Pub. L. No. 100-647, § 6236(c)(4), 102 Stat. 3740 (codified as IRC §§ 6334(a)(13) and 6334(e)).

14 Treas. Reg. § 301.6334-1(d).

15 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3445, 112 Stat. 685 (1998) (amending IRC §§ 6334(a)(13) and 6334(e)).

16 IRC § 6334(e).

17 RRA 98, Pub. L. No. 105-206, § 3445(a), 112 Stat. 685 (1998) (codified as IRC § 6334(a)(13)(A)).

18 IRC § 6323(a). *See Fairchild v. IRS*, 450 F.Supp.2d 654, 657-658 (M.D.La. 2006). The NFTL does not protect the priority of the federal tax lien against other creditors, if it is filed after the conclusion of the foreclosure action.

19 IRC § 6320 requires the IRS to provide an opportunity for the taxpayer to request a CDP hearing within 30 days after the five-business-day period following the filing of the NFTL. The IRS is not required to identify if the taxpayer owns any property before it files the NFTL. *See* IRM 5.12.2.4.1, *Criteria for Filing a NFTL* (Mar. 8, 2012).

20 IRC § 7403. The courts cannot refuse to authorize the sale to protect the interests of the taxpayer. *United States v. Rodgers*, 461 U.S. 677, 709 (1983).

amounts following foreclosure.[21] The federal tax lien and the judgment lien obtained by the IRS will survive for at least 20 years and may be extended an additional 20 years.[22]

REASONS FOR CHANGE

Taxpayers face similar economic harm whether they lose their homes through seizure or lien foreclosure. In enacting RRA 98, Congress stated its belief that seizure of a taxpayer's principal residence is particularly disruptive to the taxpayer and his or her family, and should be a last resort.[23] Yet the IRS may request that the AG seek foreclosure of the federal tax lien against a taxpayer's principal residence after the IRS files the NFTL and provides CDP hearing rights to the taxpayer.[24] The IRS increased its seizures by 21 percent and foreclosure suit referrals by 26 percent from fiscal year (FY) 2010 to FY 2012.[25] Although the administrative seizure process is generally adequate, IRS procedures suggest that ROs consider referral to the AG for a lien foreclosure suit where:

- Seizure and sale would result in a lower price paid for the property;
- Encumbrances on the property, other than the federal tax lien, make it difficult for the RO to determine the relative interests in the property;
- The taxpayer's title to the property is contested by a third party; or
- Unpaid federal tax liens are filed against only one of several co-owners and a sale of undivided partial interests is not feasible.[26]

Once the AG directs the filing of a foreclosure suit, the courts have limited equitable discretion to order the sale of the taxpayer's residence in cases where another party claims an

21 IRC § 7402(a).

22 IRC § 6322 provides that a federal tax lien shall continue until the liability is satisfied or unenforceable by reason of lapse of time. The Federal Debt Collection Procedure, 28 U.S.C.A. 3001 *et seq.*, provides the exclusive means for collection of a debt owed to the government to the extent another federal law does not specify procedures for recovering a claim or judgment that are inconsistent with it. 28 U.S.C.A. § 3002(3)(B) (2012) defines federal debts to include assessments, taxes, penalties, and interest. 28 U.S.C.A. § 3201(c) (2012) provides that a judgment lien is effective, unless satisfied, for a period of 20 years, and may be renewed for additional periods of 20 years if a notice of renewal is filed before the running of the initial 20 year period and the court approves it.

23 S. Rep. No. 105-174, at 86-87 (1998).

24 IRC §§ 6321 (tax lien arises), 6320 (CDP rights), 6323 (priority of tax lien) and 7403 (lien foreclosure suit referral). Although the IRC does not require that the IRS file an NFTL before requesting lien foreclosure, the IRS generally files an NFTL to protect the priority of the government's interest in the property the IRS is foreclosing on. *See* IRC § 6323(a).

25 IRS, Small Business/Self Employed Division (SB/SE), Collection Activity Report NO-5000-24, *Levy and Seizure Report* (Oct. 1, 2012). Department of Justice (DOJ), Tax Division, *Suits to Foreclose Tax Lien — Summary by Fiscal Year of Case Receipt* (Oct. 3, 2012). The IRS conducted 605 seizures and referred 221 lien foreclosure suits to the DOJ in FY 2010, and conducted 733 seizures and referred 278 lien foreclosure suits to the DOJ in FY 2012.

26 IRM 5.17.4.8.2.1, *Administrative Collection Devices Are Not Feasible or Adequate* (Aug. 1, 2010). Property seized and sold by the IRS under IRC § 6335 generally yields less proceeds, because the owners of real property sold, their heirs, executors, administrators, or any other person having an interest, or lien on the property, are permitted to redeem property sold at any time within 180 days after the sale under IRC § 6337(b). These parties do not have the same redemption rights in a lien foreclosure suit, because the court must determine the respective interests of these parties in the suit and issue a final order, which may be appealed by the taxpayer or party under Rule 4 of the Federal Rules of Appellate Procedure, or compromised by the AG under IRC § 7122.

interest in the property.[27] Courts could decline to order a sale of the entire property after deciding whether:

- Forced sale of the taxpayer's partial interests would yield enough proceeds so as to not prejudice the government's financial interest in the entire property.
- A non-liable party with an interest in the property would, in the normal course of events, have a legally recognized expectation that the separate property would not be subject to forced sale by the taxpayer or his or her creditors.
- Inadequate compensation and personal dislocation costs in the sale of the entire property would prejudice the financial interests of the non-liable party with an interest in the property.
- The relative character and value of the non-liable party's interest is much greater than the taxpayer's interest.
- Common sense and consideration of special circumstances support forced sale of the taxpayer's partial interest.[28]

However, the courts have no discretion to refuse to authorize the sale to protect the interests of the taxpayer.[29]

Taxpayers have no protection following IRS referral of lien foreclosure suits against their principal residences. By contrast, before the IRS may request seizure and sale of the principal residence, the IRS must prove to the court that the taxpayer has insufficient assets to pay the full amount due, and the IRS must return the residence if the seizure creates an economic hardship.[30] Taxpayers should be afforded the same rights in lien foreclosure requests against their principal residences as they would receive when the IRS seizes their principal residences.

EXPLANATION OF RECOMMENDATION

Taxpayers should be protected from loss of their principal residences by lien foreclosure because loss of a principal residence causes economic harm, disrupts taxpayers and their families, and should only be used as a last resort. Before requesting that the AG direct the filing of a suit to foreclose the federal tax lien and sell the taxpayer's principal residence, the IRS employee should receive executive-level approval after determining whether the taxpayer's other property or rights to property are insufficient to satisfy the federal tax debt, and whether the foreclosure and sale of the principal residence creates an economic hardship due to the financial condition of the taxpayer. With these protections in place, the U.S. District Court could determine whether the IRS made the appropriate mandatory

27 *United States v. Rodgers*, 461 U.S. 677, 708-709 (1983).

28 *Id.* at 710-711 (1983).

29 *Id.* at 709 (1983).

30 IRC §§ 6334(e), 6343(a)(1)(D), and 6343(d).

findings, and order or deny the foreclosure and sale of the taxpayer's principal residence accordingly.

LR #6

Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions

PROBLEM

While some taxpayers may fraudulently convey their property to friends or relatives to avoid their personal legal obligation to pay taxes, others legitimately divest their property before the IRS assesses tax. The IRS files Notices of Federal Tax Lien (NFTLs) and issues levies against the property of third parties (individuals or entities, known as transferees, nominees, or alter egos) that hold property purportedly belonging to taxpayers subject to collection.[1] However, these third parties are not considered taxpayers for the purposes of Collection Due Process (CDP) rights under Internal Revenue Code (IRC) §§ 6320 and 6330 and therefore are not entitled to CDP rights.[2] The IRS Restructuring and Reform Act of 1998 (RRA 98) failed to provide for notice, CDP hearings, and subsequent pre-payment judicial review for third parties.[3]

The purpose of CDP rights is to give taxpayers a meaningful hearing before the IRS levies their property or immediately after the IRS files a NFTL against the taxpayers' property. An independent and impartial Appeals or Settlement Officer must weigh the issues raised by the taxpayer and determine whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any proposed collection action be "no more intrusive than necessary."[4]

Without the benefit of the protections afforded by IRC §§ 6320 and 6330, the third party against whom the IRS has taken a collection action has limited remedies, provided only after the collection action has occurred.[5] These remedies are time-consuming, costly and place an undue burden on those who cannot afford the significant expense of litigating in federal district court. In some cases, the third party may not challenge the wrongful levy or an erroneous lien because he or she does not have the financial resources to do so.

As a result, the collection process for alleged nominees, alter egos, and transferees perversely denies individuals and entities who may be innocent third parties the right to raise concerns and propose collection alternatives before an action is taken, while giving the taxpayer those very rights. Amending the IRC to provide CDP rights to nominees, alter egos, and transferees would appropriately give the "affected third party" (the language used

1 Internal Revenue Manual (IRM) 5.12.2.6.4 (Oct. 30, 2009); IRM 5.17.14.1.4 and 5.17.14.2 (Jan. 24, 2012). *See also* IRM 5.11.1.2.5 (Dec. 11, 2009) and IRM 5.17.14.6.1 (Jan. 24, 2012).

2 *See* Treas. Reg. § 301.6320-1(a)(2), Q&A-A7 and (b)(2), Q&A B5; Treas. Reg. § 301.6330-1(a)(3), Q&A-A2 and (b)(2), Q&A-B5.

3 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

4 IRC § 6330(c)(1) and (c)(3)(C); H.R. Rep. No. 105-599, at 263 (1998) (Conf. Rep.).

5 *See generally* IRC §§ 6343(b) and 7426; 28 USC § 2410.

by the Senate Finance Committee in the initial draft of CDP provisions) at least as much due process protection as the person actually responsible for the tax.[6]

EXAMPLE

Jane Doe operates a small bakery that incurs tax debts and is unable to make loan payments. The IRS files an NFTL against the taxpayer, but the lender's security interest in all of the taxpayer's property and rights to property takes priority over the NFTL. To avoid foreclosure, Jane's son Jack agrees to assume and refinance the debt and acquire the business. After receiving approval from her manager and the Office of Chief Counsel, the Revenue Officer places a nominee levy on the business's credit card receipts in the belief that Jack has taken over for his mother and is acting as her nominee. Neither the Counsel attorney nor the Revenue Officer knows that Jack has legally acquired the business and paid off Jane's loan. If the IRS had provided Jack with a CDP notice and conducted a CDP hearing prior to the levy, Jack would have had the opportunity to demonstrate to an independent Appeals or Settlement Officer that he was not his mother's nominee and the Revenue Officer's initial determination could be reversed before the levy occurred. As a result of the absence of CDP rights for nominees, Jack is left with the option of bringing a wrongful levy action in U.S. District Court. He hires an attorney and prevails, but at the cost of a $30,000 retainer fee.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to "affected third parties," known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.

CURRENT LAW

IRC § 6321 creates a federal tax lien on all property and rights to property of any taxpayer who neglects or refuses to pay the tax for which the taxpayer is liable. This lien continues against the taxpayer's property until the liability either has been fully paid or is legally unenforceable.[7] To put third parties on notice and establish the priority of the government's interest in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders, the IRS must file an NFTL in the appropriate location, such as a county registry of deeds.[8]

6 *See* S. Rep. 105-174, at 67 (1998).

7 IRC § 6322. This statutory lien is sometimes called the "secret" lien, because third parties – and sometimes even the taxpayer – have no knowledge of the existence of this lien or the underlying tax debt.

8 IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.2.8 (Oct. 30, 2009).

IRC § 6331(a) authorizes the IRS to levy upon all property and rights to property of any taxpayer who neglects or refuses to pay his or her tax liability after notice and demand for payment has been made on the taxpayer.

The IRS can file NFTLs and issue levies against the property of third parties (individuals or entities), known as transferees, nominees, or alter egos that hold property belonging to taxpayers subject to collection. In general, in transferee or nominee situations, the IRS can pursue only specific property to which the NFTL has attached, while it can pursue all of the alter ego's property to collect the taxpayer's liability.[9]

- **Transferee.** If the taxpayer transfers assets for inadequate consideration, the transferee is not considered a purchaser pursuant to IRC § 6323, and the federal tax lien maintains priority over the transferee's interest in the property.[10] The IRS can file NFTLs against or levy upon property subject to a federal tax lien that has been transferred by the taxpayer, which is in the hands of the transferee or any subsequent transferee.[11]
- **Nominee.** In a nominee situation, a third party owns the property in name only for the benefit of the taxpayer, while the taxpayer remains the true owner of, or holds the equitable interest in, the property.[12] The IRS can file NFTLs against property held by a nominee in the name of the nominee, or levy upon such property subject to an NFTL to satisfy the tax liabilities of the true owner.[13]
- **Alter Ego.** The alter ego doctrine focuses on the relationship between the taxpayer and the alter ego; *i.e.*, whether the taxpayer is similar to or controls another individual, trust, business or corporation. The alter ego doctrine often involves "piercing the corporate veil" to hold an individual or shareholder liable for the debts of a business entity, although "reverse piercing" may also be used to recover a taxpayer's delinquent tax liability from his alter ego business entity.[14] When an owner is the alter ego of a corporate taxpayer or other legally distinct entity, the owner's assets may be used to satisfy the debts of the corporate taxpayer, and vice versa.[15] The IRS can take collection actions against property held in the name of the alter ego, based on the assessment against the taxpayer, including filing an NFTL in the name of the alter ego, or levying upon such property in the hands of alter ego.[16]

9 *Oxford Capital Corp. v. United States*, 211 F.3d 280, 284 (5th Cir. 2000); IRM 5.17.2.5.7(2) (Mar. 27, 2012).

10 IRC § 6323(a) and (h)(6); IRM 12.2.6.6(2) (Oct. 30, 2009). The transferee liability should not be confused with an administrative transferee assessment under IRC § 6901.

11 Subject to certain exceptions, the federal tax lien (as perfected by the NFTL) takes priority over any subsequently arising interest in the taxpayer's property. IRC § 6323((a) and (h)(6). *See also* Treas. Reg. § 301.6331-1(a)(1).

12 *See Holman v. United States*, 505 F.3d 1060 (10th Cir. 2007).

13 *See, e.g., United States v. Schaeffer*, 245 B.R. 407 (D. Colo. 1999) (former wife held property as a nominee of the taxpayer); *Allen Family Trust v. United States*, 558 F. Supp. 152 (D. Kan. 1982) (family trust is merely a nominee, a title holder for the taxpayer).

14 *Towe Antique Ford Found. v. Comm'r*, 999 F.2d 1387, 1390 (9th Cir. 1993); IRM 5.17.2.5.7.1 (Mar. 27, 2012); *Alter ego* essentially means a "second self." IRM 5.12.2.6.7 (Oct. 30, 2009).

15 *See, e.g., Oxford Capital Corp. v. United States*, 211 F.3d 280 (5th Cir. 2000); *Wolfe v. U.S.*, 798 F.2d 1241 (9th Cir. 1986); *Valley Finance v. United States*, 629 F.2d 162, 172 (D.C. Cir. 1980).

16 *Oxford Capital Corp. v. United States*, 211 F.3d 280, 284 (5th Cir. 2000).

The law requires the IRS to provide written notification (a CDP notice) to the taxpayer of the first NFTL filing for a specific tax period and of the taxpayer's right to a CDP hearing not more than five business days after the filing of the NFTL.[17] The taxpayer is entitled to one CDP hearing per tax period before an Appeals or Settlement Officer who has had no prior involvement in the matter with respect to that tax period. Similarly, IRC § 6330 requires the IRS, subject to certain exceptions, to provide written notification (a CDP notice) of its intent to levy on any property or right to property of any taxpayer at least 30 days prior to the levy and to inform the taxpayer of the right to a CDP hearing.[18] Again, the taxpayer is entitled to one hearing per tax period before an Appeals or Settlement officer who has had no prior involvement. The IRS generally cannot take any levy action pursuant to the determination during the 30 days in which the taxpayer may seek judicial review or while review is pending.

The purpose of CDP rights is to give taxpayers a meaningful hearing before the IRS levies their property or immediately after the IRS files a NFTL against the taxpayers' property.[19] The hearing allows taxpayers an opportunity to raise issues relating to the collection of the tax liability, including:

- Appropriateness of collection actions;[20]
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;[21]
- Appropriate spousal defenses;[22]
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a notice of deficiency or otherwise have an opportunity to dispute the liability;[23] and
- Any other relevant issue relating to the unpaid tax, the NFTL, or the proposed levy.[24]

In addition to addressing the issues raised by the taxpayer, the Appeals or Settlement Officer must verify that the IRS has met the requirements of all applicable laws and administrative procedures,[25] and decide whether the proposed collection action balances the

17 *See* IRC § 6320. *See also* Letter 3172, *Notice of Federal Tax Lien Filing and Your Right to a Hearing under I.R.C. § 6320*.

18 Treas. Reg. § 301.6330-1(a)(3)), Q&A-A5 (except in the case of jeopardy levies or levies on State income tax refunds). *See also* Letter 1058, *Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing*, or LT-11, *Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing*. The Letter 1058 is issued by field collection, in cases assigned to a Revenue Officer. The LT-11 is issued from a Service Center by the IRS Automated Collection System (ACS).

19 Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

20 IRC § 6330(c)(2)(A)(ii).

21 IRC § 6330(c)(2)(A)(iii).

22 IRC § 6330(c)(2)(A)(i).

23 IRC § 6330(c)(2)(B).

24 IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

25 IRC § 6330(c)(1); *Hoyle v. Comm'r*, 131 T.C. 197 (2008).

need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be "no more intrusive than necessary."[26] This balancing test is central to a CDP hearing.

However, the IRS will only give the CDP lien notice to the person described in IRC § 6321 who is named on the NFTL.[27] A CDP levy notice will only be given to the person described in IRC § 6331(a).[28] In other words, CDP rights are only available to the delinquent taxpayer — the person liable to pay the tax due after notice and demand who refuses or neglects to pay.

The IRS does not give a CDP lien notice under IRC § 6320 to a nominee, alter ego, or transferee of the taxpayer, because the third party is not the person described in IRC § 6321 and, therefore, is not entitled to such notice and CDP rights.[29] The IRS does, however, give these third parties a notice that it has filed the NFTL and provides administrative appeal rights under the Collection Appeals Program (CAP).[30] Because a CAP hearing before the IRS Office of Appeals is not a CDP hearing under IRC § 6320, any determination made as part of the CAP hearing is not subject to judicial review under IRC § 6330(d)(1).[31] Third parties may also seek reconsideration by IRS collection employees and assistance from the National Taxpayer Advocate.[32]

Similarly, the IRS does not give notice of the proposed levy to a nominee, alter ego, or transferee of the taxpayer, because the third party is not the person described in IRC § 6331(a) and is not entitled to a pre-levy CDP hearing.[33] The third party may seek reconsideration by the IRS office collecting the tax, by requesting a CAP hearing before Appeals, or by requesting assistance from the National Taxpayer Advocate. Because a CAP hearing is not a CDP hearing under IRC § 6330, any determination made as part of the CAP hearing is not subject to judicial review under IRC § 6330(d)(1).[34]

26 IRC § 6330(c)(3)(C). *See also* H.R. Rep. No. 105-599, at 263 (1998) (Conf. Rep.).

27 Treas. Reg. § 301.6320-1(a)(2), Q&A-A1.

28 Treas. Reg. § 301.6330-1(a)(3), Q&A-A1.

29 *See* Treas. Reg. § 301.6320-1(a)(2), Q&A-A7 and (b)(2), Q&A B5; IRM 5.12.2.6.4 (Oct. 30, 2009).

30 Treas. Reg. § 301.6320-1(b)(2), Q&A-B5; IRM 5.12.2.6.4(4) (Oct. 30, 2012). Letter 3177(DO), *Notice of Federal Tax Lien Filing — Nominee or Alter-Ego*.

31 Treas. Reg. § 301.6320-1(b)(2), Q&A-B5. *See also Forman v. U.S. Dept. of Treasury I.R.S.*, 2005-1 USTC ¶ 50,418 (N.D. Ill. 2005); *Gillum v. Comm'r*, 676 F.3d 633 (8th Cir. 2012).

32 Treas. Reg. § 301.6320-1(b)(2), Q&A-B5. Additionally, the third party may seek a certificate of discharge under section 6325(b)(4) and pursue any other procedures to which a third party may be entitled. *Id.*

33 Treas. Reg. § 301.6330-1(a)(3), Q&A-A2 and (b)(2), Q&A-B5.

34 Treas. Reg. § 301.6330-1(b)(2), Q&A-B5.

REASONS FOR CHANGE

Collection Due Process hearings were created by RRA 98.[35] The legislative history of IRC §§ 6320 and 6330 shows that Congress believed that "the IRS should afford taxpayers adequate notice of collection activity and a meaningful hearing before the IRS deprives them of their property."[36] CDP procedures were designed to "increase fairness to taxpayers."[37] Even though the Senate report mentioned "[t]he taxpayer (*or affected third party*)," the Conference report did not reproduce this language. (emphasis added).[38] RRA 98 did not include third-party collection doctrines and did not provide for notice, CDP hearings, and subsequent pre-payment judicial review in those instances.[39] As a result, third parties, *i.e.*, transferees, nominees, and alter egos, are afforded no CDP rights and are not entitled to judicial review of IRS collection actions in U.S. Tax Court.

While some taxpayers fraudulently convey their property to friends or relatives to avoid their personal legal obligations to pay taxes, others legitimately divest their property before the IRS makes the assessment. Some practitioners have observed the aggressive approach that the IRS has recently taken in collecting taxes from alleged nominees and alter egos of delinquent taxpayers.[40] The IRS filed a significant number of nominee and alter ego liens in fiscal years (FYs) 2008-2011, as shown on Chart 2.6.1 below.

35 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

36 S. Rep. 105-174, at 67 (1998). *See also* J. Comm. on Tax'n, General Explanation of Tax Legislation Enacted in 1998, JCS–6–98 (Nov. 24, 1998).

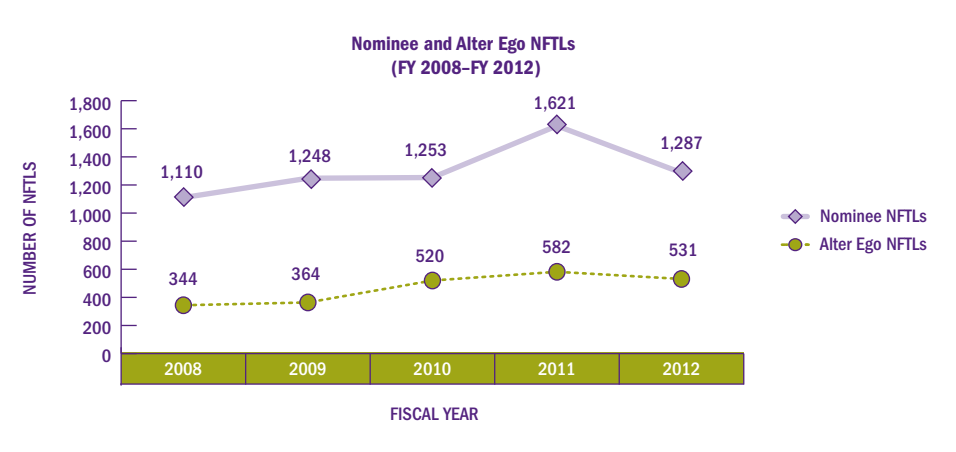
37 S. Rep. 105-174, at 67 (1998).

38 *Cf.* S. Rep. 105-174, at 67 and H.R. Rep. No. 105-599, at 265-66 (1998) (Conf. Rep.).

39 As discussed above, Treasury regulations interpreted the law as affording CDP rights and subsequent judicial review only to taxpayers and not to third parties holding the property as transferees, nominees, or alter egos. *See* Treas. Reg. § 301.6320-1(a)(2), Q&A-A7 and (b)(2), Q&A B5; Treas. Reg. § 301.6330-1(a)(3), Q&A-A2 and (b)(2), Q&A-B5. Interestingly, during the rulemaking process, two commentators brought up the issue of the lack of CDP right to third parties before the IRS codified its first permanent CDP regulation in 2002. *See* T.D. 8979, 67 Fed. Reg. 2558, 2559 (Jan. 17, 2002).

40 Robert E. McKenzie, *Nominee Liens & Alter Ego Liens*, presentation materials, American Bar Association Section of Taxation May meeting, Washington, DC (May 2012).

FIGURE 2.6.1, Nominee and Alter Ego NFTLs, FYs 2008–2012 (through August 2012)[41]



A few practitioners have perceived IRS actions aimed at collecting tax debts from third parties as "abusive."[42] Administrative remedies provided to nominees, alter egos, and transferees *post factum*, such as a request for reconsideration by the IRS office collecting the tax or an administrative appeal under the CAP program, are inadequate and ineffective because the collection action occurs *before* the IRS hears an explanation from the affected third party. Moreover, since the use of the third-party NFTL or levy requires advance IRS Office of Chief Counsel approval, the Appeals Officer may be reluctant to override counsel.[43] During a recent American Bar Association Section of Taxation webinar on nominee and alter ego liens and levies, a practitioner commented, "You walk in there and the appeals officer says, 'Well, IRS counsel signed off; that's good enough for me' . . . and you're stuck going to court."[44] Another practitioner called the level of due process for nominees, alter egos, and transferees "illusory."[45]

Without the benefit of the protections afforded by IRC §§ 6320 and 6330, the third party against whom the IRS has taken a collection action has limited remedies. If the IRS denies administrative relief or the taxpayer misses the narrow deadline for making a written request for return of the levy proceeds under IRC § 6343(b), the available judicial remedies are not likely to provide expeditious relief from the effect of the third-party NFTL or levy.[46]

41 IRS responses to TAS information request (Sept. 7 and Nov. 27, 2012).

42 Brant Goldwyn, *IRS Collection Actions Against Nominees and Alter Egos Lack Due Process, Practitioners Assert*, CCH (Aug. 9. 2012) (reporting about an American Bar Association program on the collection of taxes from nominees, transferees and alter egos).

43 Amy S. Elliott, *Increased IRS Use of Alter Ego Liens Causing Problems for Taxpayers*, 2012 Tax Notes Today 154-2 (Aug. 9, 2012).

44 *Id.*

45 *Id.*

46 Identifiable property in possession of the IRS may be returned anytime. If seized property has been sold, or if cash has been turned over to the IRS by the person upon whom a levy was served, a request for the return of levied funds or cash proceeds from the sale of levied property must be made before the expiration of nine months from the date of the levy. IRC § 6343(b); Treas. Reg. § 301.6343-2(b) and (c). *See also* National Taxpayer Advocate 2001 Annual Report to Congress 202-14 (Key Legislative Recommendation: *Return of Levy Proceeds*).

If the IRS has filed an NFTL, the third party who holds the title is left with the option to bring an action to quiet title under 28 USC § 2410.[47] To contest a nominee, alter ego, or transferee levy, the affected third party has to file a wrongful levy action under IRC § 7426 in district court.[48] In addition to being time-consuming, these remedies are often costly and place an undue burden on those who cannot afford the significant expense of litigating in federal district court.[49] In some cases, the third party may never challenge the wrongful levy or an erroneous lien because he or she does not have the financial resources to do so.[50]

The collection process for alleged nominees, alter egos, and transferees is fundamentally unfair and can produce unjust results, when an innocent third party holding the legal title to property gets no CDP protections, while the party actually responsible for the tax debt gets the full protection of IRC §§ 6320 and 6330.[51]

Amending the IRC to provide CDP rights to nominees, alter egos, and transferees would appropriately give the "affected third party" (the language used by the Senate Finance Committee in the initial draft of CDP provisions) at least as much due process protection as the person actually responsible for the tax.[52] It is also good government policy, providing extra measures of protection against abuse in the collection arena and increasing fairness and transparency in tax administration, consonant with the legislative intent of RRA 98.[53]

The availability of the CDP hearing procedure does not dictate the outcome. It simply assures the third party holding legal title to property that "the proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the [affected third party] that the collection action be no more intrusive than necessary."[54]

47 *See Baldassari v. United States*, 78-2 USTC ¶ 9560 (Cal. Ct. App.1978). If the nominee NFTL is filed without any form of levy, a wrongful levy action under IRC § 7426 is not available. *See also Nickerson v. United States*, 75-1 USTC ¶ 9455 (D.R.I.1974), *aff'd*, 513 F.2d 31 (1st Cir. 1975). Thus, the third party's creditworthiness and financial viability can be seriously impaired without any effective remedy.

48 A wrongful levy suit action must be brought within nine months of the date of the levy. IRC. § 6532(c)(1). If a request is made for return of property under section 6343(b), then the nine month period is extended for a period of twelve months from the date of filing such request or for a period of six months from the date the IRS denies the claim, whichever is shorter. IRC § 6532(c)(2).

49 *See* Stephanie Hoffer *et al.*, *To Pay or Delay: The Nominee's Dilemma Under Collection Due Process*, 82 Tul. L. Rev. 781 (2008). *See also* Emery G. Lee & Thomas E. Willging, *Defining the Problem of Cost in Federal Civil Litigation*, 60 Duke L.J. 765 (2010) (finding median litigation costs, including attorney's fees, of $15,000 for plaintiffs and $20,000 for defendants). Litigation costs for a quiet title action can exceed $30,000. American Bar Association Section of Taxation May Meeting, *Nominee and Alter Ego Liens, panel discussion* (May 2012).

50 *See* Stephanie Hoffer *et al.*, *To Pay or Delay: The Nominee's Dilemma Under Collection Due Process*, 82 Tul. L. Rev. 781, 783 (2008).

51 At a minimum, the government should provide impacted persons with notice of action and an opportunity to be heard. *See* Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before The American College of Tax Counsel, 63 Tax Law. 227 (Spring 2010).

52 *See* S. Rep. 105-174, at 67 (1998). For a more detailed discussion of due process in tax collection, see Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before The American College of Tax Counsel, 63 Tax Law.227 (Spring 2010).

53 *See* J. Comm. On Tax'n, *General Explanation of Tax Legislation Enacted in 1998*, JCS–6–98 (Nov. 24, 1998).

54 IRC § 6330(c)(3)(C); H.R. Rep. No. 105-599, at 263 (1998) (Conf. Rep.).

EXPLANATION OF RECOMMENDATION

The proposed legislative change extends CDP protections currently available to taxpayers under IRC §§ 6320 and 6330 to "affected third parties," such as nominees, alter egos, and transferees, that hold legal title to property subject to IRS collection actions. Permitting affected third parties to use CDP procedures would provide significant protective remedies from wrongful NFTLs and levies. A CDP hearing would provide these third parties with an opportunity for a meaningful independent review by the IRS Office of Appeals before the IRS issues its first levy or immediately after it files its first NFTL in the name of an alleged nominee, alter ego, or transferee. At the hearing, the third party would have the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, and in some situations the underlying tax liability.[55] Most importantly, an independent Appeals or Settlement Officer will be required to follow the CDP hearing procedures, the review requirements, and the balancing test afforded to taxpayers under current law.[56] Further, affected third parties will have the right to judicial review of Appeals' determinations provided that they timely request the CDP hearing and timely petition the U.S. Tax Court.[57] Similar to current CDP protections afforded to taxpayers, the IRS would also suspend levy actions against affected third parties during a levy hearing and any judicial review that may follow.[58]

55 IRC §§ 6320(c) and 6330(c). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test. A taxpayer cannot challenge the underlying liability in a CDP proceeding if the taxpayer has had a prior opportunity to challenge it. IRC § 6330(c)(2)(B). Furthermore, a third party holding property upon which a federal tax lien has attached may generally not challenge the assessment against the taxpayer. *Pipola v. Chicco*, 274 F.2d 909, 911-13 (2d Cir. 1960).

56 IRC § 6330(c)(1) and (c)(3)(C).

57 IRC § 6330(a)(3)(B) and (d); IRC § 6320(a)(3)(B).

58 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review upon a showing of "good cause," if the underlying tax liability is not at issue.

LR #7

Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes

PROBLEM

The payroll processing industry provides a valuable service to employers, especially small businesses, by helping them comply with complex federal, state, and local employment tax requirements. The industry also plays a significant role in tax administration by facilitating employment tax processing and collection, which can be costly and burdensome to the employer.[1] The industry has created various contractual arrangements with third party payers (TPPs) in which a TPP performs some or all of the employer's federal employment tax withholding, reporting, and payment obligations.[2]

While most TPPs are legitimate and trustworthy companies, a few "bad actors" have defrauded their clients and tarnished the image of the industry.[3] Because employers remain liable for payroll taxes, those victimized in these situations (especially self-employed and small business taxpayers) can experience significant burden. This burden includes not only being forced to pay the amount twice — once to the TPP that embezzled or dissipated the funds and a second time to the IRS — but also being liable for interest and penalties. Some small businesses may not be able to recover from these financial setbacks and will be forced to cease operations. Moreover, because the Internal Revenue Code (IRC) does not protect taxpayers from TPP failures, the IRS faces difficult decisions about how to handle these cases and often compounds the harm to victims of misappropriation, particularly small businesses that use smaller TPPs.[4] Although the payroll tax industry has evolved in the more than 60 years that have passed since employment taxes were enacted, the law has not kept up with this evolution.

EXAMPLE

A small business taxpayer hires a TPP to withhold, report, and pay employment taxes. The TPP collects payroll tax deposits from the taxpayer but does not turn them over to the IRS, and without the taxpayer's knowledge changes the taxpayer's mailing address on file with the IRS to TPP's address. Thus, when the IRS sends delinquent payroll tax notices to the taxpayer, the TPP receives and withholds them from the taxpayer. The TPP's owner uses the funds deposited by the taxpayer and other clients to fund a lavish lifestyle and pay old debts. Lacking sufficient assets to function as a going concern, the TPP is forced into

1 IRS data show a steady increase in use of paid preparers for employment tax returns. While approximately 32 percent used preparers in tax year (TY) 2009, the number increased to 34.6 percent in TY 2011. IRS Compliance Data Warehouse (CDW), Business Return Tax File Table (Oct. 2012).

2 *See* fn. 26, *infra*.

3 *See* IRS, Employment Tax Fraud, Case Examples, FY 2007 – FY 2012.

4 For almost a decade, the National Taxpayer Advocate has addressed the problem of TTP failures and recommended measures that could prevent or minimize the negative impact of these failures on employers. *See, e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 261-262; National Taxpayer Advocate 2007 Annual Report to Congress 337-354 (Most Serious Problem: *Third Party Payers*); 2004 National Taxpayer Advocate Annual Report to Congress 394-399.

bankruptcy. The taxpayer then discovers the TPP never deposited the full amount of the payroll taxes it collected with the IRS, and the small business is now liable for delinquent taxes, interest, and penalties.

RECOMMENDATIONS

To protect taxpayers from third party misappropriation of payroll taxes, the National Taxpayer Advocate recommends that Congress:

- Amend the IRC to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees.
- Amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause.
- Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.

PRESENT LAW

Employers that pay wages for services of an employee are required to deduct and withhold Social Security, Medicare, and income taxes from the wages.[5] Employers are also responsible for their share of the Social Security and Medicare tax and for tax under the Federal Unemployment Tax Act (FUTA).[6] Employers who fail to collect and deposit these taxes timely and in the correct manner are subject to penalties ranging from two percent to 15 percent of the amount of the underpayment.[7] When the monies collected from employee payroll are not paid as required, the law also provides for the assessment of a trust fund recovery penalty against individuals deemed "responsible persons."[8] The penalty is equal to the amount of Social Security, Medicare, and income taxes withheld from employees. Such taxes are referred to as "trust fund" taxes because employers hold the employees' money in trust until it is paid over to the government.[9]

Under present law, the determination of who is liable for withholding, paying, and reporting federal employment taxes depends on the existence of a common-law

5 *See* IRC §§ 3101, 3102(a) and 3402(a).

6 *See* IRC §§ 3111(a) and (b) and 3301.

7 IRC § 6656(a).

8 IRC § 6672(a). "Responsible person" is generally defined as an officer or employee of the organization, who has sufficient control and authority to collect, truthfully account for, or pay over the withheld taxes, but willfully fails to do so. IRC §§ 6671(b) and 6672(a).

9 *See* generally IRC § 7501.

employer-employee relationship.[10] Generally, the determination whether such a relationship exists is based on all the facts and circumstances tending to show whether the service recipient has the right to direct and control the method and means by which an individual performs the services.[11] If such a relationship exists, the service recipient (employer) is generally liable for employment taxes.

In 1987, the IRS published a 20-factor test for use as an analytical tool in determining whether an employer-employee relationship exists.[12] This guidance was based on an examination of court decisions and rulings concerning indicators of common-law employment. Eventually, the complexity of the test and changes in certain business practices led to a new analytical approach to determining employee classification.[13] In 2004, the IRS provided training materials for making this determination by grouping relevant facts into three general categories — behavioral control, financial control, and relationship of the parties.[14]

An employer may enter into an agreement with a third party in which the third party performs some or all of the employer's federal employment tax withholding, reporting, and payment obligations.[15] However, the law does not require the third party to be bonded to guarantee payment to the government if the third party defaults on its obligations.

Under IRC § 3504, the Secretary is authorized to issue regulations to "designate [a] fiduciary, agent, or other person" that has the "control, receipt, custody, or disposal of, or pays the wages or compensation of an employee or group of employees, employed by one or more employers," to perform acts required of employers.[16] Both the designee and the employer remain liable for payroll taxes and all penalties as long as the agent authorization made on Form 2678, *Employer/Payer Appointment of Agent*, is in effect.[17] While the IRS has created Schedule R (Form 941), *Schedule for Aggregate Form 941,* for tracking employer-agent relationships for agents with an approved Form 2678, present law does not contain specific penalties for failure to file the form.[18]

10 IRC §§ 3401(d); 3121(d)(2).

11 Treas. Reg. §§ 31.3121(d)-1 and 31.3401(c)-1.

12 *See* Rev. Rul. 87-41, 1987-1 C.B. 296.

13 *See* IRS Information Letter 2004-0087 (June 30, 2004).

14 *See* IRS *Independent Contractor or Employee? Training Materials*, Training 3320-102 (10-96) TPDS 84238I; IRS Publication 15-A, *Employer's Supplemental Tax Guide* (Jan. 2012); *see also* Present Law and Background Relating to Worker Classification for Federal Tax Purposes, Joint Committee on Taxation Report, JCX-26-07 (May 7, 2007); National Taxpayer Advocate 2008 Annual Report to Congress 375 (Legislative Recommendation: Worker Classification).

15 IRM 5.1.24.1 and IRM Exhibit 5.1.24-1 (Aug. 15, 2012). *See also* IRS, *Third Party Arrangements, available at* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Third-Party-Arrangements (last visited on Sept. 9, 2012).

16 *See* IRC § 3504; Treas. Reg. § 31.3504-1.

17 *See id.*; Rev. Proc. 70–6, 1970-1 C.B. 420. Although the current process to designate an agent on Form 2678 is voluntary, IRC § 3504 authorizes the IRS to impose duties of an employer on a designated third party or agent that pays the wages or compensation of employees on behalf of the employer by issuing regulations under § 3504.

18 The Schedule R includes a list of all employers using the agent with an approved Form 2678 and the payroll liabilities reported by the agent on the Form 941 for each employer. IRM 5.1.24.4.4.1 (Aug. 15, 2012); 21.7.2.4.4.3 (Oct.1, 2012). *See also* the Schedule R (Form 940), designed for filers of Form 940 having approved Forms 2678. IRM 21.7.3.4.7 (Oct. 1, 2012)

Bankruptcy Code § 523(a)(1) provides that bankruptcy "does not discharge an individual debtor" from taxes given priority under 11 U.S.C. § 507(a)(8), but does not address situations where a business entity has a tax debt. The employment tax debt (including the TFRP) of individual debtors cannot be discharged in bankruptcy.[19] There is no comparable provision for business entities in bankruptcy.

REASONS FOR CHANGE

Following the enactment of IRC Subtitle C, *Employment Taxes and Collection of Income Tax*, some 65 years ago, the payroll industry has established various TPP arrangements for reporting, filing, and paying employment taxes. TPPs include payroll service providers (PSPs),[20] agents with approved Forms 2678,[21] Reporting Agents (Form 8655 *Reporting Agent Authorization*),[22] and Professional Employer Organizations (PEOs).[23] However, Congress has not amended the IRC to reflect the evolution of the industry, nor to authorize the IRS to better regulate the growing use of various TPP arrangements.[24]

Employment tax noncompliance by a TPP may lead to delinquent client accounts, creating a growing amount of uncollected tax liability.[25] Between FY 2007 and FY 2012, acting on the IRS's recommendations, the Department of Justice criminally prosecuted at least 24 owners and operators of different types of TPPs that collected about $300 million in employment taxes from their client employers and did not turn the funds over to the Treasury.[26]

When a TPP goes out of business or misappropriates its clients' funds, the employers remain liable for the unpaid taxes. Defunct TPPs usually lack sufficient assets to collect against upon default, leaving the IRS no recourse other than to collect from the employers.

19 *See* 11 U.S.C. § 507(a)(8)(C) and 523(a)(1); *United States v. Sotelo*, 436 U.S. 268, 275 (1978) (holding that debts incurred under IRC § 6672 are not dischargeable and are treated as priority taxes in bankruptcy).

20 IRM 5.1.24.4.2 (Aug. 15, 2012). PSPs are third parties paid by an employer to administer payroll and employment tax responsibilities, including one or more of the following: prepare paychecks for employees; prepare employment tax returns using the employer's Employer Identification Number (EIN); file employment tax returns for the employer, which are signed by the employer; make federal tax deposits and payments; and prepare Form(s) W-3 and Form(s) W-2 for the employees using the employer's EIN.

21 Such an agent files an aggregate employment tax return on Form 941 under its own EIN reporting employment taxes related to wages paid on behalf of all of its client/employers. Both the agent with an approved Form 2678 and the employer are liable for the employer's employment taxes while the agent authorization is in effect. See IRC § 3504; Rev. Proc. 70–6, 1970-1 C.B. 420; Form 2678, *Employer/Payer Appointment of Agent.* Only agents of home care service recipients authorized under IRC § 3504 may file an aggregate Form 940. See Rev. Proc. 80-4, 1980-1 C.B. 581; Notice 2003-70, 2003-43 I.R.B. 916; IRM 21.7.3.4.6 (Jan. 24, 2011).

22 *See* Rev. Proc. 2012-32, 2012-35 I.R.B. 1. Reporting Agents only report and deposit employment taxes, but are not in position of control and do not pay wages to the employees. A Reporting Agent is not liable for an employer's employment taxes.

23 PEOs (also known as employee leasing companies) enter into agreements with clients to provide employees to perform services for the client, pay compensation to the employees, and assume responsibility to collect, report, and pay employment taxes under their own EINs. A PEO may represent to a client that the PEO is the employer of the workers providing services to the client. IRM 5.1.24.6 and IRM Exhibit 5.1.24-1 (Aug. 15, 2012).

24 *See* IRS, *Third Party Arrangements*, *available at* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Third-Party-Arrangements (last visited Sept. 9, 2012).

25 *See, e.g.*, IRM 5.1.24.5.1(2) (Aug. 15, 2012).

26 IRS, Employment Tax Fraud, Case Examples, FY 2010 – FY 2012, available at http://www.irs.gov/uac/Examples-of-Employment-Tax-Fraud-Investigations-Fiscal-Year-2012 (Last visited Sept. 11, 2012).

Each TPP failure can cause grave financial harm to multiple clients, which may be required to pay the amount of payroll taxes twice: once to the TPP and again to the IRS with interest and penalties.[27] Many employers also must invest significant time and additional expense for representation in attempting to resolve their liabilities with the IRS. Some small businesses that cannot recover from these setbacks may be forced to cease operations and lay off their employees.

During the past five years, the IRS, in collaboration with TAS,[28] has acted to address the negative impact of TPP failures on employers. Its actions include:

- Publishing a new IRM section describing TPP arrangements for employment taxes,[29] and
- Implementing new procedures for assessment of the TFRP against TPPs, including responsible parties within a PSP or a PEO.[30]

Yet these provisions do not ameliorate the double burden on the employer for its share of unpaid tax due to a TPP misappropriation or bankruptcy. Absent statutory authority to require bonding and regulate TPPs that assume a responsibility to withhold, report, and pay employment taxes, the IRS has limited tools to protect employers victimized by unscrupulous TPPs.[31]

The tax system has at least two reasons to protect taxpayers harmed by TPP failures:

- First, this problem primarily affects small businesses, few of which have sufficient cash flow to pay the amount of employment taxes twice in addition to interest and penalties. This tax burden may be heavy enough to jeopardize a business's status as a going concern. Significantly, this taxpayer has done its best to comply with its tax obligations and should not be treated like a willfully noncompliant taxpayer.
- Second, TPPs have not only a contractual obligation to their clients but a responsibility to the tax system as a whole. They are in fact profiting from obligations imposed on taxpayers by the tax system. Thus, the government has a legitimate interest in ensuring that TPPs faithfully discharge this responsibility.

27 *See, e.g.*, IRC §§ 6656(a) and 6672(a). One TPP's executives embezzled about $1.3 million from about 3,000 clients across the country. The Morning Call, *Two Easton-area Men Stole Nearly $1.3 million from New Jersey Payroll Company* (Oct. 24, 2011). Another TPP's bankruptcy left about 1,500 clients with unpaid employment taxes. The Washington Post, *The Culprit Could Be Dead, But Local Tax Case Lives On* (Oct. 13, 2008)

28 Acting upon recommendations in the 2007 Annual Report to Congress, the IRS established a joint task force with TAS to work on third party payer failures in spring 2008. See National Taxpayer Advocate 2007 Annual Report to Congress 337-354 (Most Serious Problem: *Third Party Payers*).

29 IRM 5.1.24, *Field Collecting Procedures, Third-Party Payer Arrangements for Employment Taxes* (Aug. 15, 2012).

30 *See* IRM 5.7.3.3.3 (July 19, 2012); SB/SE, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer*, SBSE-05-0711-044 (July 1, 2011). This guidance is consistent with a 2004 legislative recommendation by the National Taxpayer Advocate. See National Taxpayer Advocate 2004 Annual Report to Congress 394-399.

31 As stated above, the process to designate an agent under IRC § 3504 is voluntary, and some TPPs, *e.g.*, PEOs, do not take advantage of the process because they consider and represent themselves to be employers.

EXPLANATION OF RECOMMENDATIONS

The National Taxpayer Advocate recommends closing loopholes in the tax law that a few "bad actors" in the payroll industry use to harm others. The recommendations protect both the government's and taxpayers' interests in preventing employment tax misappropriation and increasing compliance.

Currently, the IRS and the courts determine who is liable for withholding, paying, and reporting federal employment taxes generally based on the identification of the common-law employer.[32] Except for agents with an approved Form 2678, TPPs are not jointly and severally liable for employment taxes and applicable penalties under any provision of the IRC, including § 3504. The IRS lacks statutory authority to require bonding of TPPs.

While the IRS has taken several steps to regulate agents with an approved Form 2678 and Reporting Agents, it lacks authority to protect the public fisc and the affected employers from risks posed by PEOs and PSPs.[33] For example, even though the IRS created Schedule R for Forms 941 and 940 (Employer's Annual Federal Unemployment (FUTA) Tax Return) to track and cross-reference employer-agent relationships, it lacks statutory authority to penalize noncompliant agents with an approved Form 2678.[34]

Requiring bonding for any person who enters into an agreement with an employer to collect, report, and pay any employment taxes would protect the government and employers from TPP misappropriation.[35] The IRS should be given broad regulatory authority to exempt certain TPP arrangements, such as those involving Reporting Agents or agents with an approved Form 2678 described above, from the bonding requirement. The National Taxpayer Advocate recommends that Congress authorize the IRS to impose monetary penalties on TPPs for failure to obtain adequate bonding.[36]

In addition, requiring agents with an approved Form 2678 to file a form with the IRS that allocates reported and paid employment taxes among their client employers, and subjecting noncompliant agents to penalty for failure to file, will minimize the risk of TPP misappropriation.

32 The courts are reluctant to hold the third party payers jointly and severally liable for embezzled payroll taxes because it is "not a corporate officer or in a position of authority" and does "not have final control over [the employer's] taxpaying duties." *Pediatric Affiliates, P.A. v. United States.*, 2006-1 U.S.T.C. (CCH) ¶ 50,201 (D.N.J. 2006).

33 *See* Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Payroll Service Provider Failures and Increase Employment Tax Compliance, supra.*

34 Only agents of home care service recipients authorized under IRC § 3504 may file an aggregate Form 940. *See* Rev. Proc. 80-4, 1980-1 C.B. 581; Notice 2003-70, 2003-43 I.R.B. 916; IRM 21.7.3.4.6 (Jan. 24, 2011).

35 For example, federal law requires performance bonds for contractors participating in federal construction projects. Such bonds must specifically guarantee payment of federal payroll taxes. See generally 40 U.S.C. § 3131(c)(1).

36 The Secretary may also be authorized to waive the bonding requirement for payroll agents that meet certain high standards, *e.g.*, maintaining adequate reserves or depositing withheld payroll taxes via the Electronic Federal Tax Payment System (EFTPS) or another electronic system.

Finally, the proposal to amend 11 U.S.C. § 523(a) to specifically provide that IRC § 6672 penalties are not discharged in bankruptcy with respect to non-individual responsible persons will expand the reach of victims to corporate assets of the failed TPP. This clarification would further protect taxpayers that use TPPs that fail to pay over taxes to the IRS and then declare bankruptcy.[37]

37 This legislative change would not provide relief to the employer for its share of unpaid tax due to a TPP misappropriation or bankruptcy.

Most Litigated Issues: Introduction

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(X) requires the National Taxpayer Advocate to identify in her Annual Report to Congress (ARC) the ten tax issues most litigated in federal courts (Most Litigated Issues).[1] The National Taxpayer Advocate may analyze these issues to develop recommendations to mitigate the disputes resulting in litigation.

The Taxpayer Advocate Service (TAS) identified the Most Litigated Issues from June 1, 2011, through May 31, 2012, by using commercial legal research databases. For purposes of this section of the Annual Report, the term "litigated" means cases in which the court issued an opinion.[2] This year's Most Litigated Issues are:

- Summons enforcement (IRC §§ 7602(a), 7604(a), and 7609(a));
- Accuracy-related penalty (IRC § 6662(b)(1) and (2));
- Collection due process (CDP) hearings (IRC §§ 6320 and 6330);
- Trade or business expenses (IRC § 162(a) and related Code sections);
- Gross income (IRC § 61 and related Code sections);
- Failure to file penalty (IRC § 6651(a)(1)), failure to pay penalty (IRC § 6651(A)(2), and estimated tax penalty (IRC § 6654));
- Civil actions to enforce federal tax liens or to subject property to payment of tax (IRC § 7403);
- Frivolous issues penalty (IRC § 6673 and related appellate-level sanctions);
- Relief from joint and several liability for spouses (IRC § 6015); and
- Limitations on assessment (IRC § 6501).

The majority of these issues were identified as Most Litigated Issues last year, with the exception of the limitations on assessment.[3] Notably, taxpayers litigating this issue succeeded in full or part in the greatest percentage of all Most Litigated Issues, with a 42 percent success rate. Summons enforcement remained the top issue this year. The number of CDP cases increased significantly after falling for two years in a row — from 89 in 2011 to 116 in 2012.[4] Cases with accuracy-related penalty issues rose from 55 in 2011 to 117 in 2012, a 113 percent increase.[5]

1 Federal tax cases are tried in the United States Tax Court, United States District Courts, the United States Court of Federal Claims, United States Bankruptcy Courts, United States Courts of Appeals, and the United States Supreme Court.

2 Many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers' cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Additionally, courts can issue less formal "bench opinions," which are not published or precedential. *See Study of Tax Court Cases in which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC), infra.*

3 See National Taxpayer Advocate 2011 Annual Report to Congress 587.

4 See id. at 589, Table 3.0.1; National Taxpayer Advocate 2010 Annual Report to Congress 416, Table 3.0.1.

5 *See id.*

Once TAS identified the Most Litigated Issues, it analyzed each one in four sections: summary of findings, description of present law, analysis of the litigated cases, and conclusion. Each case is listed in Appendix III, which categorizes the cases by type of taxpayer (*i.e.*, individual or business).[6] Appendix III also provides the citation for each case, indicates whether the taxpayer was represented at trial or argued the case *pro se* (*i.e.*, without representation), and lists the court's decision.[7]

We have also included a "Significant Cases" section summarizing decisions that are not among the top ten issues but are relevant to tax administration.[8] This year, the Significant Cases discussion includes two decisions issued by the Supreme Court that impact tax adminstration issues.[9]

In Volume 2 of this year's report is a TAS study of Earned Income Tax Credit (EITC) cases where the IRS conceded the EITC issue without trial, but only after the case was already in the United States Tax Court.[10] Settled cases are not included in the count of cases for the Most Litigated Issues; however, this research study is relevant because most Tax Court cases (80 percent in fiscal year 2011) are settled.[11] The study's findings demonstrate the burden placed on taxpayers when the IRS examination function does not operate properly. In most cases, taxpayers try to resolve their problems by calling the IRS before they file their Tax Court petitions, calling five times on average, and in most cases, taxpayers submit documentary evidence that an Appeals Officer or Chief Counsel attorney accepts as probative of the claim.[12] Taxpayers often submit their documentation only after petitioning the Tax Court, however, even though they have usually spoken with an IRS examiner beforehand. This suggests that taxpayers are willing to talk with the IRS before they petition the Tax Court and can provide acceptable supporting documentation, but do not obtain the information necessary to enable them to substantiate their claims from their conversations with examiners. Moreover, examiners reject documents that Appeals Officers or Chief Counsel attorneys later accept as substantiation of claimed EITC, and sometimes misapply the law.

6 Individuals filing Schedules C, E, or F are deemed business taxpayers for purposes of this discussion even if items reported on such schedules were not the subject of litigation.

7 *"Pro se"* means "for oneself; on one's own behalf; without a lawyer." *Black's Law Dictionary* (9th ed. 2009). For purposes of this analysis, we considered the court's decision with respect to the issue analyzed only. A "split" decision is defined as a partial allowance on the specific issue analyzed. The citations also indicate whether decisions were on appeal at the time this report went to print.

8 Two of the cases discussed in the "Significant Cases" section of this report were decided outside the June 1, 2011, through May 31, 2012, period used to identify the ten most litigated issues, but we nonetheless have included these cases because of their impact on tax administration.

9 *United States v. Home Concrete & Supply, LLC* 132 S. Ct. 1836 (2012) and *National Fed'n of Indep. Businesses et al. v. Sebelius* 132 S. Ct. 2566 (2012).

10 See Volume II: *Study of Tax Court Cases in which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*, *infra*.

11 Counsel Automated Tracking System, TL -711.

12 See Volume II: *Study of Tax Court Cases in which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*, *infra*.

AN OVERVIEW OF HOW TAX ISSUES ARE LITIGATED

Initially, taxpayers can generally litigate a tax matter in four different courts:

- The United States Tax Court;
- United States District Courts;
- The United States Court of Federal Claims; and
- United States Bankruptcy Courts.

With limited exceptions, taxpayers have an automatic right of appeal from decisions of any of these courts.[13]

The Tax Court is generally a "prepayment" forum. In other words, taxpayers can access the Tax Court without having to pay the disputed tax in advance. The Tax Court has jurisdiction over a variety of issues, including deficiencies, certain declaratory judgment actions, appeals from collection due process hearings, relief from joint and several liability, and determination of employment status.[14]

The United States District Courts and the United States Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full,[15] and (2) the taxpayer has filed an administrative claim for refund.[16] The United States District Courts, along with the bankruptcy courts in very limited circumstances, provide the only fora in which a taxpayer can receive a jury trial.[17] Bankruptcy courts can adjudicate tax matters that were not adjudicated prior to the initiation of a bankruptcy case.[18]

ANALYSIS OF *PRO SE* LITIGATION

As in previous years, many taxpayers appeared before the courts *pro se*. Table 3.0.1 lists the Most Litigated Issues for the review period of June 1, 2011, through May 31, 2012, and identifies the number of cases, broken down by issue, in which taxpayers appeared without representation. As the table illustrates, the issues with the highest rates of *pro se* appearance are summons enforcement and the frivolous issues penalty.

13 *See* IRC § 7482, which provides that the United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) have jurisdiction to review the decisions of the Tax Court. There are exceptions to this general rule. For example, IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals $50,000 or less) for which appellate review is not available. *See also* 28 U.S.C. § 1294 (appeals from a United States District Court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court).

14 IRC §§ 6214; 7476-7479; 6330(d); 6015(e); 7436.

15 28 U.S.C. § 1346(a)(1). See *Flora v. United States*, 362 U.S. 145 (1960), *reh'g denied*, 362 U.S. 972 (1960).

16 IRC § 7422(a).

17 The bankruptcy court may only conduct a jury trial if the right to a trial by jury applies, all parties expressly consent, and the district court specifically designates the bankruptcy judge to exercise such jurisdiction. 28 U.S.C. § 157(e).

18 *See* 11 U.S.C. § 505(a)(1) and (a)(2)(A).

TABLE 3.0.1, *Pro Se* Cases by Issue

Most Litigated Issue	Litigated Cases Reviewed	*Pro Se* Litigation	Percentage of *Pro Se* Cases
Summons Enforcement	153	123	80%
Accuracy-Related Penalty	117	53	45%
Collection Due Process	116	81	70%
Trade or Business Expenses	115	71	62%
Gross Income	92	53	58%
Failure to File, Failure to Pay, and Estimated Tax Penalties	74	52	70%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	48	22	46%
Frivolous Issues Penalty (and analogous appellate-level sanctions)	40	37	93%
Joint and Several Liability	40	18	45%
Limits on assessment	33	9	27%
Total	**828**	**519**	**63%**

Table 3.0.2 affirms our contention that overall, taxpayers are more likely to prevail if they are represented.

TABLE 3.0.2, Outcomes for *Pro Se* and Represented Taxpayers

	Pro Se Taxpayers			Represented Taxpayers		
Most Litigated Issue	Total Cases	Taxpayer Prevailed in Whole or in Part	Percent	Total Cases	Taxpayer Prevailed in Whole or in Part	Percent
Summons Enforcement	123	1	1%	29	0	0%
Accuracy-Related Penalty	53	14	26%	64	26	41%
Collection Due Process	81	9	11%	35	6	17%
Trade or Business Expenses	71	23	32%	44	13	30%
Gross Income	53	5	9%	39	11	28%
Failure to File, Failure to Pay, and Estimated Tax Penalties	52	6	12%	22	2	9%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	22	0	0%	26	2	8%
Frivolous Issues Penalty (and analogous appellate-level sanctions)	37	4	11%	3	0	0%
Joint and Several Liability	18	7	39%	22	12	55%
Limits on Assessment	9	1	11%	24	13	54%
Total	**519**	**70**	**13%**	**308**	**85**	**28%**

Most Litigated Issues: Significant Cases

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.[1] These decisions are summarized below.

In *United States v. Home Concrete & Supply, LLC,* the Supreme Court held that a taxpayer's overstatement of basis, and resulting understatement of gross income, did not trigger the extended six-year limitations period on assessment under IRC § 6501(e).[2]

The IRS ordinarily must assess a deficiency against a taxpayer within three years after the return is filed.[3] This period is extended to six years, under IRC § 6501(e), if a taxpayer "omits from gross income" an amount which exceeds 25 percent of the amount of gross income shown on the return.

More than three years but less than six years after the taxpayer filed a return, the IRS identified an overstated basis of sufficient magnitude to trigger the extended period, and assessed additional tax.[4] The taxpayer argued that, because an overstatement of basis is not an "omission from gross income," it did not trigger the extended limitations period, and the assessment was time-barred.

As the case was being litigated, the Treasury Department promulgated regulations interpreting the statute in its favor, so that an overstatement of basis could trigger the extended limitations period.[5] It has consistently held this position notwithstanding a 1958 loss before the Supreme Court in *Colony,* a case construing a nearly identical provision of the 1939 code, which held that the extended limitations period did not apply to cases involving an overstatement of basis.[6]

The government won at the District Court for the Eastern District of North Carolina, but lost before the Court of Appeals for the Fourth Circuit and the Supreme Court.[7] The

1 Tax cases decided by the Supreme Court may be included in this section, however, even if also discussed in connection with one of the ten most litigated issues. When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2011, and ending on May 31, 2012. For purposes of this section of the report, we generally use the same time period.

2 132 S. Ct. 1836 (2012) [hereinafter *Home Concrete*]. For prior discussion of this issue, see National Taxpayer Advocate 2010 Annual Report to Congress 418, 423 (discussing *Intermountain Insurance Service of Vail, LLC v. Comm'r,* 134 T.C. 211 (2010), *rev'd*, 650 F.3d 691 (D.C. Cir. 2011), *vacated* 132 S. Ct. 2120 (2012) [hereinafter *Intermountain*]); National Taxpayer Advocate 2009 Annual Report to Congress 407, 416 (discussing *Bakersfield Energy Partners, LP v. Comm'r*, 568 F.3d 767 (9th Cir. 2009)). For a general discussion of the statute of limitations issues raised in this case and others, see Most Litigated Issue: *Limitations on Assessment Under Internal Revenue Code Section 6501, infra.*

3 IRC § 6501(a).

4 The tax "basis" for determining the gain or loss from the sale or other disposition of property is generally the taxpayer's cost, as adjusted. *See* IRC §§ 1011, 1001. A taxpayer may understate gain on a disposition of property by overstating basis or understating the amount realized.

5 *See* Treas. Reg. § 301.6501(e)-1(a)(iii).

6 *The Colony, Inc. v. Comm'r*, 357 U.S. 28 (1958) [hereinafter *Colony*]. Although *Colony* was decided on the basis of the predecessor of current IRC § 6501(e), the Court noted that its decision was "in harmony" with the "unambiguous" language of IRC § 6501, which had recently been enacted as part of the 1954 IRC. *Id*. at 37. The 1939 IRC language is identical to the language at issue in *Home Concrete*, except that "per centum" was replaced by "percent." *Home Concrete*, 132 S. Ct. at 1840.

7 *United States v. Home Concrete & Supply, LLC*, 599 F.Supp.2d 678 (E.D.N.C. 2008), *rev'd*, 634 F.3d 249 (4th Cir. 2011), *aff'd*, 132 S. Ct. 1836 (2012).

Supreme Court declined to give deference to Treasury regulations it deemed inconsistent with its prior decision in *Colony*.

Under the Court's analysis in *Chevron*, agency regulations are entitled to deference unless (1) they contradict an unambiguous statute, or (2) adopt an unreasonable construction of it.[8] In *Colony*, the Court acknowledged that the statute's language was ambiguous.[9] For that reason, the IRS argued that its regulations should receive deference. The Court rejected this logic, reasoning that because *Colony* had already interpreted the statute, the language was no longer ambiguous, and the agency could no longer adopt a different interpretation. Justice Scalia broke from the majority, however, writing his own concurring opinion about why the regulations were not entitled to deference, leaving no majority explanation for the holding.[10]

Justice Breyer's plurality opinion, joined by Justices Roberts, Thomas, and Alito, reasoned that unlike post-*Chevron* decisions, the *Colony* Court's statement that the statute was ambiguous did not embody the normally-implicit conclusion that Congress had delegated gap-filling or clarifying authority to the agency. Rather, after *Colony* employed the traditional tools of statutory construction, it was clear that there was no gap to be filled, or ambiguity to be clarified, by agency regulations.

In a concurring opinion, Justice Scalia stated that if the plurality wanted to stand by its prior decision in *Brand X,* which held that "a court's judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute,"[11] it should have concluded that the regulations were unreasonable. He urged the Court to abandon *Brand X* as overly reliant on the "magic words 'ambiguous' and 'unambiguous.'"[12]

This case settles the controversy about whether an extended period of limitations applies to cases where an understatement of income is the result of an overstatement of basis.[13] It also suggests that an agency's regulations may not be entitled to deference if they are inconsistent with a court's interpretation of a statute — especially the Supreme Court's

8 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

9 In *Colony*, the Court stated that the 1939 code provision at issue was ambiguous, but also stated that the same provision of the 1954 code was unambiguous.

10 Justice Scalia indicated that he had joined the majority because taxpayers justifiably relied on *Colony*. *Home Concrete*, 132 S. Ct. at 1846.

11 *Id*. at 1846 (quoting *Nat'l Cable & Telecomms. Ass'n. v. Brand X Internet Serv.*, 545 U.S. 967, 982 (2005)).

12 *Id*.

13 The Supreme Court vacated and remanded five circuit court decisions, which held that an overstatement of basis produces an omission from gross income that triggers the extended assessment limitations period under IRC § 6501(e)(1)(A). *See Beard v. Comm'r,* 633 F.3d 616 (7th Cir. 2011), *vacated*, 132 S.Ct. 2099 (2012); *Grapevine Imports Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011), *vacated*, 132 S.Ct. 2099 (2012); *Salman Ranch Ltd. v. Comm'r*, 647 F.3d 929 (10th Cir. 2011), *vacated*, 132 S.Ct. 2100 (2012); *Intermountain Ins. Servs. of Vail LLC v. Comm'r,* 650 F.3d 691 (D.C. Cir. 2011), *vacated*, 132 S.Ct. 2120 (2012); *UTAM Ltd. v. Comm'r*, 645 F.3d 415 (D.C. Cir. 2011), *vacated*, 132 S.Ct. 2100 (2012). The Supreme Court also denied certiorari in four cases in which a circuit court held that a basis overstatement did not constitute an omission from gross income for purposes of triggering the extended limitations period for assessment. *United States v. Burks*, 633 F.3d 347 (5th Cir. 2011), *cert. denied*, 132 S.Ct. 2099 (2012); *Comm'r v. DSDBL Ltd.*, 436 Fed.Appx. 384 (5th Cir. 2011), *cert. denied*, 132 S.Ct. 2099 (2012); *Comm'r v. Equip. Holding Co.*, 439 Fed.Appx. 368 (5th Cir. 2011), *cert. denied*, 132 S.Ct. 2122 (2012); and *Comm'r v. R & J Partners*, 441 Fed.Appx. 271 (5th Cir. 2011), *cert. denied*, 132 S.Ct. 2100 (2012).

interpretation — that is set forth in a pre-*Chevron* decision, even if the decision acknowledges that the statute is ambiguous.[14]

In *National Federation of Independent Businesses et al. v. Sebelius,* the Supreme Court held that (1) the "penalty" under IRC § 5000A for failure to purchase health insurance was a constitutional exercise of Congress's power to tax; (2) the tax did not have to be apportioned among the states under the Direct Tax Clause; and (3) the Anti-Injunction Act did not bar the suit challenging its constitutionality.[15]

Twenty-six states, private individuals, and an organization of independent businesses challenged the constitutionality of the Patient Protection and Affordable Care Act of 2010 (PPACA). The PPACA includes an "individual mandate," codified at IRC § 5000A, which provides that an individual taxpayer who fails to maintain adequate health insurance coverage must include a "shared responsibility payment" on his or her federal income tax return.[16]

The shared responsibility payment has many characteristics of a tax: it does not apply to those whose household incomes are below the IRS's filing threshold; factors such as taxable income, number of dependents, and joint filing status determine the amount of the payment; the statute itself is codified in the IRC; and the IRS enforces and collects it, even though the IRS is prohibited from using certain tools to do so.[17]

First, the Supreme Court addressed the Anti-Injunction Act (AIA), which ordinarily bars suits "for the purpose of restraining the assessment or collection of any tax," so that those seeking judicial review generally must pay the tax and then sue for a refund.[18] It concluded the AIA did not bar the suit because Congress labeled the shared responsibility payment a "penalty," not a "tax." The Court would not apply the AIA to a payment labeled as a penalty, even if the label was inaccurate, unless Congress explicitly provided that the penalty in question would be treated as a tax for purposes of the AIA, as it has done for certain penalties. IRC § 6671(a) provides that penalties in Title 26, subchapter 68B, are treated as taxes

14 *See* William J. Wilkins, IRS Chief Counsel, Prepared remarks to ABA Tax Section (May 12, 2012), *in IRS Chief Counsel Speech Examines Government Loss In Home Concrete*, 2012 TNT 94-25 (May 15, 2012) ("[A]lthough maybe some exceptions exist, I think we will find that pretty much all pre-Chevron Supreme Court [decisions] should be read as final determinations that cannot be changed through regulations. For post-Chevron cases, we will have to look for whether the word 'ambiguous' is used, because, as Justice Scalia points out, everyone now knows that is the magic word that signals that there is room to adopt a different statutory interpretation through regulations.").

15 132 S. Ct. 2566 (2012) [hereinafter *NFIB*].

16 Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 1501, 124 Stat. 119, 244 (2010) (effective for tax years ending after Dec. 31, 2013).

17 *NFIB*, 132 S.Ct. at 2594.

18 IRC § 7421(a).

under Title 26, which includes the AIA. The individual mandate is not in subchapter 68B. Thus, it is not treated as a tax for purposes of the AIA.[19]

Next, the Court held that although Congress does not have the authority to require individuals to buy insurance under the Commerce Clause or Necessary and Proper Clause, the individual mandate and shared responsibility payments are authorized under its power to lay and collect taxes. It explained that the shared responsibility payment is a tax for Constitutional purposes because (1) for most people, "the payment is far less than the price of insurance," thus, people may rationally chose not to purchase insurance; (2) the payment is not limited to willful violations, as penalties for unlawful acts often are; and (3) the IRS collects the payment through "the normal means of taxation," but not those means "most suggestive of a punitive sanction, such as criminal prosecution."[20]

Finally, although the Direct Tax Clause of the U.S. Constitution requires that a capitation or other direct tax be apportioned so that each state pays it in proportion to its population, the Court concluded the shared responsibility payment was not a capitation or other direct tax.[21] This Constitutional limit may apply to certain direct taxes on property or capitations paid by every person "without regard to property, profession, or any other circumstance."[22] Because the shared responsibility payment is not a tax on property and only those who fail to purchase health insurance pay it, it is Constitutional even though not apportioned.[23]

In *Massachusetts v. U.S. Department of Health and Human Services*, the U.S. Court of Appeals for the First Circuit held unconstitutional the Defense of Marriage Act's (DOMA) prohibition against the filing of joint federal income tax returns by same-sex couples.[24]

For purposes of federal law, section three of the Defense of Marriage Act (DOMA) defines "marriage" as a legal union between one man and one woman as husband and wife, and

19 The Court did not specifically address whether the suit was barred under the Declaratory Judgment Act (DJA), even though the DJA overlaps with the AIA in baring suits to contest unpaid taxes and is not found in Title 26. *See, e.g., Cohen v. United States*, 650 F.3d 717, 722 (D.C. Cir. 2011) (indicating that the limitations imposed by the DJA are generally interpreted as being "coterminous" with the limitations imposed by the AIA). The U.S. Court of Appeals for the Sixth Circuit acknowledged the potential applicability of the DJA to the PPACA suit, but did not specifically address it either. *See Thomas More Law Center v. Obama*, 651 F.3d 529, 539 (6th Cir. 2011) (acknowledging that, "[I]n language at least as broad as the Anti-Injunction Act, the Declaratory Judgment Act forbids declaratory judgment action with respect to Federal taxes." (Internal citations omitted)).

20 *NFIB*, 132 S. Ct. at 2595-2596.

21 U.S. Const. Art. I, § 9, cl. 4.

22 *NFIB*, 132 S. Ct. at 2599 (citing *Hylton v. United States*, 3 Dall. 171, 174 (1796) (opinion of Chase, J.)).

23 To the extent this suggests that the Constitutional limit on direct taxes should be interpreted narrowly, it weakens the argument that various consumption taxes would be unconstitutional. *Compare* Erik Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 Colum. L. Rev. 2334 (Dec. 1997) *with* Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1 (Jan. 1999) (arguing that the direct tax limitations should be interpreted narrowly).

24 682 F.3d 1 (1st Cir. 2012), *petition for cert. filed* (U.S. July 3, 2012) (No. 12-15). For a discussion of unanswered federal tax questions posed by state laws governing domestic partnerships, see National Taxpayer Advocate 2010 Annual Report to Congress 211 (Most Serious Problem: *State Domestic Partnership Laws Present Unanswered Federal Tax Questions*) and Status Update: *Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses*, *supra*. For prior coverage of this case, see National Taxpayer Advocate 2010 Annual Report to Congress 418, 426-427 (discussing *Gill v. Office of Pers. Mgmt.*, 699 F. Supp. 2d 374, 375 (D. Mass. 2010), *aff'd sub. nom. Massachusetts v. U.S. Dep't. of Health & Human Servs.*, 682 F.3d 1 (1st Cir. 2012) [herinafter *Gill*], which is the lower court's decision in this case).

"spouse" as a person of the opposite sex who is a husband or a wife.[25] DOMA does not invalidate same-sex marriages that certain states recognize as legal. However, by prohibiting the federal government from recognizing them, it deprives same-sex married couples of many of the benefits enjoyed by opposite-sex married couples. For example, same-sex couples are not entitled to the tax benefits associated with filing a joint federal income tax return.[26]

In *Gill*, taxpayers brought suit to enjoin federal agencies from enforcing DOMA to deprive them of federal marriage-based benefits in violation of the equal protection principles embodied in the Due Process Clause of the Fifth Amendment.[27] Laws involving classifications that discriminate against certain "suspect" classes, such as race, are subject to "strict scrutiny," which requires that the government have a compelling interest for the policy and that the policy be narrowly tailored to achieve the governmental interest by the least restrictive means.[28] Gender-based classifications are subject to "intermediate scrutiny," requiring the law or policy to be substantially related to furthering an important government objective.[29] Laws discriminating against certain other classes of individuals are generally constitutional if they pass a "rational basis" test,[30] which simply requires the government policy to be rationally related to a legitimate governmental interest.[31] The district court did not need to decide if strict (or intermediate) scrutiny applied because it concluded, "'there exists no fairly conceivable set of facts that could ground a rational relationship' between DOMA and a legitimate government objective."[32] Thus, it held that DOMA failed a rational-basis inquiry and violated the equal protection principles embodied in the Fifth Amendment.

In a consolidated appeal, the U.S. Court of Appeals for the First Circuit agreed that DOMA is unconstitutional. While the court concluded that it could not extend "strict" scrutiny by adding a new suspect class, it applied "intensified" scrutiny, which the Supreme Court has applied in cases where "minorities are subject to discrepant treatment," and requires that the government interest be shown with "special clarity" when it intervenes in areas where state regulation has traditionally governed.[33] The court recognized that this case was not just about same-sex marriage, but also about a federal law intruding into a realm

25 Defense of Marriage Act (DOMA), Pub. L. No. 104-199, § 3(a), 110 Stat. 2419 (1996) (codified at 1 U.S.C. § 7).

26 A 2004 study by the Government Accountability Office (GAO) found that 1,138 federal statutory provisions tied benefits, protections, rights, or responsibilities to marital status. *See* GAO, GAO-04-353R, *Defense of Marriage Act: Update to Prior Report* (2004).

27 *Gill*, 682 F.3d at 376.

28 *See, e.g., Adarand Constructors, Inc. v. Peña,* 515 U.S. 200 (1995).

29 *See Craig v. Boren,* 429 U.S. 190 (1976).

30 Rational basis review usually leads to a ruling favorable to the government, as courts normally show deference to any legitimate governmental interest. *See* Gayle L. Pettinga, *Rational Basis with Bite: Intermediate Scrutiny by Any Other Name,* 62 Ind. L.J. 779 (1987).

31 *See, e.g., FCC v. Beach Commc'ns*, 508 U.S. 307 (1993).

32 *Gill*, 682 F.3d at 387. Prior to the enactment of DOMA, federal law incorporated each state's marital status determinations. The government asserted that Congress enacted DOMA to preserve the *status quo* definitions of "marriage" and "spouse" during a time of debate when the status of same-sex marriage and related definitions were changing in individual states.

33 *Massachusetts*, 682 F.3d at 10.

traditionally controlled by the states — domestic relations and the regulation of marriage. Therefore, DOMA required more than the most deferential rational basis review.

Ultimately, the court concluded that the rationales offered by Congress for the enactment of DOMA — encouraging responsible procreation; defending heterosexual marriage and traditional notions of morality; protecting state sovereignty and democratic self-governance; and preserving scarce government resources — did not withstand intensified scrutiny or show the government's interest with special clarity. Thus, it held DOMA unconstitutional, but stayed implementation of its decision pending a likely appeal to the Supreme Court.[34]

In *Windsor v. United States*, the U.S. Court of Appeals for the Second Circuit held unconstitutional DOMA's denial of a spousal deduction to a same-sex couple in computing the federal estate tax, and the United States Supreme Court has granted *certiorari*.[35]

Edie Windsor and her late spouse, Thea Spyer, long-time New York residents, were married in Canada in 2007. Spyer died in 2009. Because of section three of DOMA, Windsor did not qualify for the unlimited marital deduction, under IRC § 2056(a), and was required to pay federal estate tax on Spyer's estate. Windsor paid the tax in her capacity as executor of the estate and filed suit, seeking a refund of the federal estate tax levied on Spyer's estate and a declaration that section three of DOMA violates the Equal Protection Clause of the Fifth Amendment.

After concluding that Windsor and Spyer's marriage would be recognized under New York state law, the United States District Court for the Southern District of New York held DOMA violated the Equal Protection Clause of the U.S. Constitution because it lacked a rational basis.

The U.S. Court of Appeals for the Second Circuit affirmed the district court. First, it distinguished *Baker v. Nelson*, in which the Supreme Court summarily dismissed a challenge to Minnesota law prohibiting same-sex marriage "for want of a substantial federal question."[36] It distinguished *Baker* as involving the constitutionality of a *state* law and cited significant developments since *Baker* was decided in 1971.[37] It noted that marriage is an area that has long been regarded as a virtually exclusive province of the States, but that DOMA is a federal law.

34 *See Petition for Writ of Certiorari, Bipartisan Legal Advisory Grp. of the U.S. House of Representatives v. Gill*, No. 12-15 (U.S. July 3, 2012).

35 699 F.3d 169 (2nd Cir. 2012), *cert. granted* (Dec. 7, 2012) (No. 12-307) [hereinafter *Windsor*]. Although the 2nd Circuit's opinion was not decided within the reporting period, the lower court's decision, which was affirmed by the 2nd Circuit, was issued on June 2, 2011 (within the reporting period). *See Windsor v. United States*, 797 F. Supp. 2d 320 (S.D.N.Y. 2011).

36 409 U.S. 810 (1972).

37 Intermediate level scrutiny had not been established in 1971. The Supreme Court had not yet ruled that a classification of homosexuals for its own sake lacked a rational basis. *See Romer v. Evans*, 517 U.S. 620 (1996). Nor had it yet ruled that the government could not make private homosexual conduct a crime. *See Lawrence v. Texas*, 539 U.S. 558 (2003).

Next, it recognized same-sex married couples as a "quasi-suspect" class and applied "intermediate scrutiny." It reasoned (1) homosexuals have endured historic discrimination, (2) homosexuality has no relation to aptitude or ability to contribute to society, (3) homosexuals are a discernable group, and (4) the class remains a politically weak minority. To withstand intermediate scrutiny, a law must be substantially related to an important government interest. The court concluded that the rationales offered by Congress for the enactment of DOMA (described in *Gill*, summarized above) did not withstand intermediate scrutiny because they were not substantially related to an important government interest. Thus, it held DOMA unconstitutional. This case is particularly important because the Supreme Court has granted certiorari.

In *Estate of Petter v. Commissioner*, the U.S. Court of Appeals for the Ninth Circuit upheld a "reallocation clause" that allowed a taxpayer to avoid gift tax even after an IRS audit determined that a gift had been undervalued.[38]

After inheriting a large amount of United Parcel Service (UPS) stock, Ms. Petter's advisors designed a complex trust arrangement allowing her to maximize the stock she could give to her two children without having to pay gift tax. She transferred her UPS stock to a family-owned limited-liability company (LLC). She gave a specified number of LLC units to trusts controlled by her children, and gave the remaining units to two charities. The specified number of LLC units transferred to the trusts was the number worth a specified dollar amount – the amount that Ms. Petter could transfer tax-free to her children. A "reallocation clause" in the transfer documents required the trusts to transfer additional units to the charities if the value of the units initially received was "finally determined for federal gift tax purposes" to exceed the specified dollar amount that Ms. Petter could transfer tax-free.[39]

On her gift tax return, Ms. Petter claimed that interests in the LLC were worth 59.3 percent less than the stock because LLC interests are less marketable than stock and because the LLC operating agreement restricted sales of the LLC interests. The IRS challenged the value of the transfers, and the parties ultimately settled on a 36 percent discount. Thus, the settlement triggered a transfer of additional LLC units from the trusts to the charities pursuant to the reallocation clauses.

The IRS viewed the reallocation clauses as requiring a second transfer of value to the charities that was contingent upon the outcome of the IRS's audit. Thus, it argued they were either invalid as against public policy, or constituted a "condition precedent" that made the transfers nondeductible under Treas. Reg. § 25.2522(c)-3(b)(1).[40] Citing the general public

38 653 F.3d 1012 (9th Cir. 2011).

39 Coupling the transfers of LLC units to the trusts with simultaneous transfers to charities created a "charitable freeze," an "estate planning technique that seeks to ensure that if the IRS successfully challenges a taxpayer's valuation of a gift, the amount by which the gift was undervalued does not go to the IRS as estate or gift tax, but rather to one or more charities named by the donor." *Estate of Petter,* 653 F.3d at 1015 n.2.

40 Treas Reg. § 25.2522(c)-3(b)(1) reads in relevant part, "[I]f, as of the date of the gift, a transfer for charitable purposes is dependent upon the performance of some act or of the happening of a precedent event in order that it might become effective, no deduction is allowable."

policy in favor of encouraging gifts to charities and similar formulaic clauses that the IRS and the courts have endorsed, the Tax Court sided with Ms. Petter.[41]

The U.S. Court of Appeals for the Ninth Circuit agreed, reasoning that under the terms of the original transfer, the charities had the right to receive a pre-defined number of LLC units, even though that number would be determined by a formula.[42] Thus, the IRS's determination that the LLC units had a greater fair market value than originally believed did not grant the charities the right to receive additional units. It merely ensured that they received the units they were originally entitled to receive. Accordingly, Treas. Reg. § 25.2522(c)-3(b)(1), did not bar Ms. Petter from claiming a charitable deduction equal to the value of the additional units received by the charities after the IRS audit determined the units had been undervalued. The court invited Treasury to "amend its regulations if troubled by the consequences of our resolution of this case."[43]

This case demonstrates how a donor can make wealth transfer tax valuations "essentially audit proof," at least according to some commentators.[44] The IRS has no incentive to audit a donor's valuation if a successful audit is likely to increase the amount transferred to charity, rather than to increase the tax due to the IRS. In cases where charities have a practical and legal ability and incentive to prevent undervaluation of gifts they receive, IRS enforcement may not be necessary. The rationale of this case, however, may extend to situations where donee charities either have no ability or incentive to enforce their rights.[45]

In *Fort Properties, Inc. v. American Master Lease LLC*, the U.S. Court of Appeals for the Federal Circuit held that a method for applying the tax-deferred property exchange rules under IRC § 1031 to "deed-shares" was not a patentable subject matter, even though some claims would be implemented using a computer.[46]

American Master Lease LLC (AML) patented a method by which the property interests in a real estate portfolio are divided into shares (called "deed-shares") and sold to investors like stock. Each deed-share could be encumbered by its own mortgage debt and exchanged tax-free for other "like-kind" property under IRC § 1031. Fort Properties, Inc., a real estate company, brought action against AML, seeking a declaration that it was not infringing AML's patent.[47]

The district court concluded that the patent was invalid because it sought to cover an abstract idea.[48] It applied the *Bilski* Court's "machine or transformation" test which limits

41 *Estate of Petter v. Comm'r*, T.C. Memo. 2009-280, *aff'd*, 653 F.3d 1012 (9th Cir. 2011).

42 The IRS did not pursue its public policy argument on appeal.

43 *Estate of Petter,* 653 F.3d at 1023.

44 *See, e.g.*, John A. Bogdanski, *Defined Value Clauses Keep Trumping IRS Revaluations*, 39 *Est. Plan*. 37, 43 (Jan. 2012).

45 *Id.*

46 671 F.3d 1317 (Fed. Cir. 2012), *aff'g* 609 F. Supp. 2d 1052 (C.D. Cal. 2009), *reh'g denied* (May 29, 2012).

47 *Fort Props. Inc. v. Am. Master Lease,* LLC, 609 F.Supp.2d 1052 (C.D. Cal. 2009), *aff'd*, 671 F.3d 1317 (Fed. Cir. 2012).

48 *Id.* at 1056.

patentable subject matter to methods that (1) are tied to a particular machine or (2) transform an article into a different state or thing.[49] According to the patent, a computer would be used to generate the deed-shares, but AML admitted in its patent application that the method "need not be performed by a computer."[50] Thus, the district court concluded the process was not tied to a machine. Because the court also concluded that the creation or transfer of a deed-share did not transform an article or thing (only legal ownership), it held the patent invalid.

The U.S. Court of Appeals for the Federal Circuit agreed.[51] It analyzed other cases involving abstract business methods and concluded that the abstract concepts covered by the deed-share investment tool patent could not be transformed into a patentable subject matter merely because of connections to the physical world through deeds, contracts, and real property. It also concluded that claims covering the use of a computer were not sufficient to render the subject matter patentable because they did not impose meaningful limits on the claim's scope.

In 2011, following recommendations from the American Institute of CPAs (AICPA), the National Taxpayer Advocate, and others, Congress barred the issuance of tax strategy patents.[52] But the law applied prospectively, meaning that the roughly 160 tax strategy patents already issued by the U.S. Patent and Trademark Office remain on the books.[53] Accordingly, this case is significant because it provides guidance for determining the extent to which these tax strategy patents are valid.

In *Sarmiento v. United States*, the U.S. Court of Appeals for the Second Circuit held that the IRS's contractual right to retain a taxpayer's "overpayment of tax" under the terms of an offer-in-compromise included the right to retain refundable credits.[54]

On November 14, 2007, married taxpayers entered into separate offer-in-compromise (OIC) agreements to settle unpaid tax liabilities. The taxpayers signed the standard IRS Form 656, *Offer in Compromise*, which requires that the taxpayer must agree to offer, as

49 *In re* Bilski, 545 F.3d 943 (Fed. Cir. 2008), *aff'd sub nom. Bilski v. Kappos*, 130 S. Ct. 3218 (2010) [hereinafter *Bilski*]. For prior discussion of Bilski, see National Taxpayer Advocate 2009 Annual Report to Congress 403, 407; National Taxpayer Advocate 2010 Annual Report to Congress 414, 418.

50 *Fort Props., Inc.*, 609 F. Supp. 2d at 1056.

51 The federal circuit acknowledged that the Supreme Court had subsequently indicated that that the "machine-or-transformation" test is simply "a useful and important clue, an investigative tool" and is not "the sole test for deciding whether an invention is a patent-eligible 'process.'" *Bilski*, 130 S. Ct. at 3227. Accordingly, the federal circuit's analysis focused more on precedent than on the machine-or-transformation test applied by the district court.

52 *See, e.g.*, AICPA Position on Patents for Tax Planning Methods (2011), http://www.aicpa.org/Advocacy/Issues/DownloadableDocuments/TaxStrategyPatents/TSP_Overview_112th_Congress.pdf; National Taxpayer Advocate 2007 Annual Report to Congress 512 (Key Legislative Recommendation: *Eliminate Tax Strategy Patents*). The Leahy-Smith America Invents Act prevents a person from patenting a tax strategy that could subject taxpayers to royalties for using the strategy when filing their tax returns, except in connection with their use of software for financial services management, or return preparation or filing. Pub. L. No. 112-29, § 14, 125 Stat. 284, 327-28 (2011) (codified as 35 U.S.C. § 102 (note)).

53 *See* AICPA, *List of 161 Issued Tax Strategy Patents as of 9/16/11 Date of Enactment that Remain in Existence* (Sept. 16, 2011), http://www.aicpa.org/InterestAreas/Tax/Resources/TaxPatents/DownloadableDocuments/InterestingPatents/Existing_Issued_Tax_Strategy_Patents_as_of_9_16_11_date_of_enactment.doc. For further analysis, see Jeremiah Coder, *Tax Patents Face Higher Bar After Federal Circuit Ruling*, 2012 TNT 41-3 (Feb. 29, 2012).

54 678 F.3d 147 (2d Cir. 2012).

"additional consideration" to the IRS "overpayment of any tax or other liability, for tax periods extending through the calendar year in which the IRS accepts the offer." The taxpayers paid the amounts required under their offers in 2008.

In early 2008, the taxpayers filed a joint return for 2007, claiming refundable credits, including the Earned Income Tax Credit, the Additional Child Tax Credit, and the Economic Stimulus Payment. The IRS retained these amounts, concluding that they constituted "additional consideration" under the terms of the OIC agreements and denied the taxpayer's administrative claim to recover them.

The IRS reasoned that its interpretation of Form 656 was consistent with IRC § 6401(b)(1), which provides that if certain refundable credits exceed a taxpayer's tax liability, "the amount of such excess *shall be considered* an overpayment." In addition, IRC § 6428(g) treats the economic stimulus payments as a constructive overpayment of taxes, and "deems the stimulus credit to be a refund of this constructive overpayment." Thus, the IRS concluded the credits were properly offset as "overpayments" for 2007.

The U.S. Court of Appeals for the Second Circuit found for the IRS. While the taxpayers acknowledged that the amounts in question were treated as "overpayments" under the IRC, their primary argument was that the terms "refund" and "overpayment," as used in the OIC agreements, should be afforded their "ordinary 'plain English'" meaning. The court rejected this argument, reasoning that, like Form 1040, *U.S. Individual Income Tax Return*, Form 656 is a specialized tax document and its terms must take their meaning from the IRC. Any other conclusion could inject unnecessary uncertainty into the interpretation of standard tax forms.

Second, the taxpayers argued that the stimulus payment related to 2008 – beyond the tax period covered by the overpayment offset provision. The court disagreed, concluding that the "advance refunds" provided by the stimulus payments under IRC § 6428(g) granted eligible taxpayers "a refund applicable to the 2007 tax year." Thus, even though the credits would be applied in 2008, they were actually a "refund" of 2007 taxes, and therefore were properly retained by the IRS as additional consideration under the OIC agreements executed in 2007.

Finally, the taxpayers argued that they could not have agreed to allow the IRS to retain the stimulus payment because Congress had not enacted stimulus payments when they signed the Form 656. The court concluded that, because the language of Form 656 is unambiguous, by agreeing to the overpayment provision, the taxpayers assumed the risk that they would become eligible for unanticipated tax credits that they would have to forfeit. This

case is significant because it clarifies how to interpret Form 656 and may provide insight into how the IRS and the courts will interpret other closing agreements.[55]

In *Bemont Investments, LLC v. United States*, the U.S. Court of Appeals for the Fifth Circuit Court held that the 40 percent gross valuation misstatement penalty did not apply because the IRS totally disallowed the loss.[56]

On his 2001 return, Mr. Beal claimed losses attributable to a tax shelter designated as a "listed transaction." The IRS disallowed the losses because it disregarded the entities and transactions that purported to generate them as shams, lacking economic substance. The IRS sought various penalties including the 40 percent gross valuation misstatement penalty.

The district court found that because the IRS totally disallowed the losses, the overstatement was not "attributable to" a "valuation misstatement." Thus, it applied the 20 percent negligence penalty, rather than the 40 percent gross valuation misstatement penalty. Relying on the *Todd* and *Heasley* cases, the Fifth Circuit Court of Appeals affirmed the district court's holding on this point.[57]

In a concurring opinion, Circuit Court Judge Prado, joined by Judges Reavley and Davis, criticized *Todd* and *Heasley*, arguing they had misinterpreted the Joint Committee on Taxation's General Explanation (called the Blue Book) of the how to apply the gross valuation misstatement penalty. The Blue Book explains that the penalty is computed after taking unrelated adjustments to other items into account, but sheds no light on how to apply the penalty when a single item is disallowed on more than one basis (*e.g.*, both a gross valuation misstatement and a lack of economic substance), according to Judge Prado.[58]

The IRS will continue to argue that the gross valuation misstatement penalty applies if an overvaluation is an integral part of a transaction, regardless of the grounds for disallowance

55 This case may also highlight the continuing need for legislation to protect the EITC from being fully offset by the IRS. *See* National Taxpayer Advocate 2009 Annual Report to Congress 366-370. Under certain hardship circumstances, the IRS, using refund offset bypass procedures (OBR), may deviate from its normal procedures and give the taxpayer his or her refund rather than offset the refund to an outstanding tax liability under IRC § 6402. See IRM 21.4.6.5.12.1 (Aug. 31, 2012). The National Taxpayer Advocate will explore whether a taxpayer who is suffering a hardship and has entered an OIC might be able to use the OBR procedures to bypass the offset of a refund for the calendar year in which the IRS accepts the offer without defaulting on the agreement.

56 679 F.3d 339 (5th Cir. 2012).

57 *See Todd v. Comm'r*, 862 F.2d 540 (5th Cir. 1988); *Heasley v. Comm'r*, 902 F.2d 380 (5th Cir. 1990). The court also discounted the IRS's argument that Treas. Reg. § 1.6662-5(g), which explains that a value or basis of zero may be considered a gross valuation misstatement, negated the holdings of these cases. *Bemont*, 679 F.3d at 348 n.5.

58 Judge Prado's reasoning was cited with approval by the Federal Circuit Court of Appeals in June 2012. *See Alpha I, L.P. ex rel. Sands v. United States*, 682 F.3d 1009, 1029-30 (Fed. Cir. 2012).

of the related deduction or credit.[59] This case is significant because it highlights a split of authority concerning the applicability of the gross valuation misstatement penalty.[60]

In *Tigers Eye Trading, LLC v. Commissioner*, the U.S. Tax Court held that it had jurisdiction to determine the partners' outside bases and accuracy-related penalties in a partnership-level proceeding, notwithstanding a seemingly contrary holding by the court to which an appeal would lie.[61]

The tax matters partner of *Tigers Eye Trading, LLC* (*Tigers Eye*), an entity that had engaged in a tax shelter, entered a stipulated decision, which the Tax Court approved in 2009. Pursuant to the decision, Tigers Eye was disregarded for Federal income tax purposes, its outside basis was reduced to zero, and partner-level accuracy-related penalties were applicable. Thus, the 40 percent gross valuation misstatement penalty applied to the partners' overstatement of outside bases.[62]

In 2010, the Court of Appeals for the D.C. Circuit, the court to which *Tigers Eye* would be appealable, issued its decision in *Petaluma FX Partners, LLC v. Commissioner.*[63] *Petaluma* held that the Tax Court lacked jurisdiction to determine the partners' outside bases and accuracy-related penalties in a partnership-level proceeding.[64] In partnership-level proceedings, the Tax Court generally has jurisdiction only with respect to "partnership items," the allocation of such items, and penalties or additional amounts which relate to an adjustment to a partnership item.[65] The D.C. Circuit reasoned that outside basis was an "affected item" and not a "partnership item." Thus, the IRS would need to adjust the partners' outside bases by issuing a notice of deficiency to them (rather than by making a direct computational adjustment), which they could then dispute in the Tax Court.

After the *Petaluma* decision, Tigers Eye filed a motion for the Tax Court to revise its stipulated decision to remove the penalties applicable to the partners' outside bases. Tigers Eye argued that under the "*Golsen* rule," the Tax Court did not have jurisdiction to approve a

59 *Keller v. Comm'r,* 556 F.3d 1056, 1061 (9th Cir. 2009), *aff'g in part, rev'g in part and remanding* T.C. Memo. 2006–131, *action on dec.* 2011-02, I.R.B. 2011-44 (Oct. 31, 2011) (nonacq.). The IRS may also oppose a taxpayer's concession in cases involving abusive tax shelter transactions if the application of valuation misstatement penalties is at issue. *See* CC-Notice 2012-001 (Oct. 5, 2011).

60 As the Judge Prado observed, "[E]xcept for the Ninth Circuit, every sister circuit that has considered the issue has concluded that the valuation misstatement penalty may apply even if the deduction is totally disallowed because the underlying transaction lacked economic substance." *Bemont*, 679 F.3d at 354. However, a 40 percent penalty now also applies to transactions that lack economic substance, potentially reducing the importance of determining whether an amount was disallowed on the basis of a gross valuation misstatement or a lack of economic substance. *See* Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409, 124 Stat. 1029 (Mar. 30, 2010) (codified at IRC §§ 7701(o), 6662(b)(6), 6662(i), and 6676(c) and applicable to transactions entered into after March 30, 2010, the date of enactment). *See also*, IRC § 6664(d)(2) (no reasonable cause exception for transactions lacking economic substance).

61 138 T.C. No. 6 (2012), *appeal docketed sub nom. Logan Trust v. Comm'r,* No. 12-1148 (D.C. Cir. Mar. 16, 2012) [hereinafter *Tigers Eye*].

62 The Tax Court had previously denied the participating partners' right to interpose the partner-level reasonable cause defenses to accuracy-related penalties. *Id*. at 17, n.10.

63 591 F.3d 649 (U.S. App. D.C. 2010), *aff'd*, T.C. Memo. 2012-142 [hereinafter *Petaluma*].

64 Other courts have followed *Petaluma* in this regard. *See, e.g., Jade Trading, LLC v. United States*, 598 F.3d 1372 (Fed. Cir. 2010), *aff'g in part, vacating and remanding in part* 80 Fed. Cl. 11 (2007). For a discussion of *Petaluma*, see National Taxpayer Advocate 2010 Annual Report to Congress 422.

65 IRC § 6226(f).

stipulated decision covering outside basis and partner-level penalties given the circuit court decision in *Petaluma*.[66]

The Tax Court denied Tigers Eye's motion, holding that it had jurisdiction. It noted that in *Petaluma* the government had conceded that outside basis was an affected item, arguing instead that the Tax Court had jurisdiction because the elements of an affected item (partner-level penalties) consisted entirely of partnership items.[67] Because *Petaluma* did not consider precisely the same issue, the Tax Court concluded that *Golsen* did not apply and characterized some of its analysis as "dicta." The Tax Court also cited the recent decisions of the Supreme Court and D.C. Circuit in *Mayo* and *Intermountain* for the proposition that federal courts must defer to regulations, rather than follow earlier case law.[68] The Tax Court went on to conclude that, because the partnership was disregarded for tax purposes, the disallowance of outside bases was a partnership item over which it had jurisdiction, and that it also had jurisdiction to determine partner-level accuracy-related penalties that flowed from the disallowance.

This decision addresses important questions about the scope of the Tax Court's jurisdiction in partnership-level proceedings. However, it may also be significant because the court's rationale for not applying the so-called *Golsen* rule suggests that the Tax Court will not always follow decisions of a circuit court to which a case is appealable.[69]

66 *See Golsen v. Comm'r*, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971) (holding that the Tax Court would follow the case law of the Circuit to which a case was appealable).

67 In a status report filed May 19, 2010, the government made the same concession in *Tigers Eye*. See *Tigers Eye*, 138 T.C. No. 6 *160 (J. Wherry, concurring, and characterizing the statement as a concession of fact). According to press accounts, a contrary position "could easily prejudice the government in other ongoing litigation." Shamik Trivedi, *Tax Court Thumbs its Nose at D.C. Circuit's Ruling on TEFRA Jursidiction*, 2012 TNT 31-2 (Feb. 15, 2012) (quoting Thomas A. Cullinan).

68 *Mayo Found. for Medical Educ. & Research v. U.S.*, 131 S. Ct. 704 (2011), *aff'g* 568 F.3d 675 (8th Cir. 2009), *rev'g* 503 F. Supp. 2d 1164 (D. Minn. 2007) [hereinafter *Mayo*]; *Intermountain*, *supra*. For summaries of these cases, see National Taxpayer Advocate 2011 Annual Report to Congress 593, 594 (discussing *Mayo*) and National Taxpayer Advocate 2010 Annual Report to Congress 418, 423 (discussing *Intermountain*). As J. Holmes observes in dissent, however, the D.C. Circuit cited the regulations in *Petaluma* and no one had challenged their validity. *Tigers Eye*, 138 T.C. No. 6 *200-02.

69 J. Holmes, in dissent, characterizes the majority opinion as a brazen challenge to the D.C. Circuit's precedent – a "reverse benchslap." *Tiger's Eye*, 138 T.C. No. 6 *211.

MLI #1

Summons Enforcement Under IRC §§ 7602, 7604, and 7609

SUMMARY

The IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability.[1] To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information.[2]

A person who has a summons served upon him or her may contest its legality if the government petitions to enforce it.[3] If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons.[4] Generally, the burden on the taxpayer to establish the illegality of the summons is heavy.[5] We identified 153 federal cases decided between June 1, 2011 and May 31, 2012 that included issues of IRS summons enforcement. The parties contesting the summonses did not fully prevail in any of these cases, but one case resulted in a split decision, and the IRS prevailed in the remaining 152 cases. Of 13 cases with docketed appeals, five have since been dismissed.

PRESENT LAW

The IRS has broad authority under IRC § 7602 to issue a summons to examine a taxpayer's books and records or demand testimony under oath.[6] Further, the IRS may obtain information related to an investigation from a third party if, subject to the exceptions of IRC § 7609(c), it provides notice to the taxpayer or other person identified in the summons.[7] However, the IRS may not issue a summons *after* referring the matter to the Department of Justice (DOJ).[8] If the recipient fails to comply with a summons, the United States may commence an action under IRC § 7604 in the appropriate United States District Court to compel production or testimony.[9] If the United States files a petition to enforce the summons, the taxpayer may contest the validity of the summons in that proceeding.[10] Also,

1 Internal Revenue Code (IRC) § 7602(a)(1); Treas. Reg. § 301.7602-1.

2 IRC § 7602(a).

3 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

4 IRC § 7609(b).

5 *Hill v. U.S.*, 2012 U.S. Dist. LEXIS 73696 (W.D. Mo. 2012), *adopting* 2012 U.S. Dist. LEXIS 73699 (W.D. Mo. 2012).

6 IRC § 7602(a). *See also LaMura v. U.S.*, 765 F.2d 974, 979 (11th Cir. 1985) (citing *U.S. v. Bisceglia*, 420 U.S. 141, 145-146 (1975)).

7 IRC § 7602(c). Those entitled to notice of a third-party summons (other than the person summoned) must be given notice of the summons within three days of the day on which the summons is served to the third party, but no later than the 23rd day before the day fixed on the summons on which the records will be reviewed. IRC § 7609(a).

8 IRC § 7602(d). This restriction applies to "any summons, with respect to any person if a [DOJ] referral is in effect with respect to such person." IRC § 7602(d)(1).

9 IRC § 7604.

10 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

if the summons is served upon a third party, any person entitled to notice may initiate a petition to quash the summons in an appropriate U.S. District Court, or intervene in any proceeding regarding the enforceability of the summons.[11]

A taxpayer or other person named in a third-party summons is generally entitled to notice,[12] but there are exceptions. For example, the IRS is not required to give notice if the summons is issued to aid in the collection of "an assessment made or judgment rendered against the person with respect to whose liability the summons is issued."[13] This exception reflects congressional recognition of a difference between a summons issued in an attempt to compute the taxpayer's taxable income, and a summons issued after the IRS has made an assessment or obtained a judgment. For example, notice would not be necessary where the IRS has made the assessment and is attempting to determine whether the taxpayer has an account in a certain bank with sufficient funds to pay the tax. Giving taxpayers notice in such a situation would seriously impede the IRS's ability to collect the tax.[14] The courts have interpreted this "aid of collection" exception to apply only where the taxpayer owns a legally identifiable interest in the account or other property for which records are summoned.[15] Another situation where no notice is necessary is when an IRS criminal investigator serves a summons, in connection with a criminal investigation, on any person who is not the third-party recordkeeper.[16]

Regardless of whether the taxpayer contests the summons in a motion to quash or a response to an IRS petition to enforce, the legal standard is the same.[17] In *United States v. Powell*, the Supreme Court set forth four threshold requirements that must be satisfied to enforce an IRS summons:

- The investigation must be conducted for a legitimate purpose;
- The information sought must be relevant to that purpose;
- The IRS must not already possess the information; and
- All required administrative steps must have been taken.[18]

11 IRC § 7609(b). The petition to quash must be filed not later than the 20th day after the date on which the notice was served. IRC § 7609(b)(2)(A).

12 IRC § 7609(a)(1); *Jordan v. U.S.*, 108 A.F.T.R.2d (RIA) 6821 (S.D. Ohio 2011), *adopted by* 108 A.F.T.R.2d (RIA) 6824 (S.D. Ohio 2011).

13 IRC § 7609(c)(2)(D)(i). The exception also applies to the collection of a liability of "any transferee of any person referred to in clause (i)." IRC § 7609(c)(2)(D)(ii).

14 H.R. Rep. No. 94-658 at 310, reprinted in 1976 U.S.C.C.A.N. at 3206. *See also* S. Rep. No. 94-938, pt. 1, at 371-371, *reprinted in* 1976 U.S.C.C.A.N. at 3800-01 (containing essentially the same language).

15 *Ip v. U.S.*, 205 F.3d 1168, 1172-76 (9th Cir. 2000).

16 IRC § 7609(c)(2)(E). A third-party record keeper is broadly defined and includes banks, consumer reporting agencies, persons extending credit by credit cards, brokers, attorneys, accountants, enrolled agents, and owners or developers of computer source code but only when the summons "seeks the production of the source or the program or the data to which the source relates." IRC § 7603(b)(2).

17 *Phillips v. IRS*, 99 A.F.T.R.2d (RIA) 3487 (D. Ariz. 2007).

18 *U.S. v. Powell*, 379 U.S. 48, 57-58 (1964).

The IRS bears the initial burden of establishing that these requirements have been satisfied.[19] However, this burden is minimal, as the government need only introduce a sworn affidavit of the agent who issued the summons declaring that each of the Powell requirements has been satisfied.[20] The burden then shifts to the person contesting the summons to demonstrate that the IRS did not meet the requirements or that enforcement of the summons would be an abuse of process.[21]

A taxpayer may also allege that the information requested is protected by a statutory or common-law privilege, such as the

- Attorney-client privilege;[22]
- Tax practitioner privilege;[23] or
- Work-product privilege.[24]

However, these privileges are limited. For example, they extend to "tax advice," but not to tax return preparation materials.[25] Another limitation is the "tax shelter" exception, which permits discovery of communications between a tax practitioner and client that promote participation in any tax shelter.[26] Under the tax shelter exception, the tax practitioner privilege does not apply to any written communication between a federally authorized tax practitioner and "any person, any director, officer, employee, agent, or representative of the person, or any other person holding a capital or profits interest in the person" which is "in connection with the promotion of the direct or indirect participation of the person in any tax shelter."[27] A tax shelter is defined as "a partnership or any other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax."[28]

19 *Fortney v. U.S.*, 59 F.3d 117, 119-20 (9th Cir. 1995).

20 *U.S. v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993).

21 *Id*.

22 The attorney-client privilege provides protection from discovery of information where:
(1) legal advice of any kind is sought, (2) from a professional legal advisor in his or her capacity as such, (3) the communication is related to this purpose, (4) made in confidence, (5) by the client, (6) and at the client's insistence protected, (7) from disclosure by the client or the legal advisor, (8) except where the privilege is waived. *U.S. v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing John Henry Wigmore, *Evidence in Trials at Common Law* § 2292 (John T. McNaughten rev. 1961)).

23 IRC § 7525 extends the protection of the common law attorney-client privilege to federally authorized tax practitioners in federal tax matters. Criminal tax matters and communications regarding tax shelters are exceptions to the privilege. IRC § 7525(a)(2), (b). The tax practitioner privilege is interpreted based on the common law rules of the attorney-client privilege. *U.S. v. BDO Seidman, LLP*, 337 F.3d 802, 810-812 (7th Cir. 2003), *cert. denied, Roes v. U.S.*, 540 U.S. 1178 (2004).

24 The work-product privilege protects against the discovery of documents and other tangible materials prepared in anticipation of litigation. Fed. R. Civ. P. 26(b)(3); *see also Hickman v. Taylor*, 329 U.S. 495 (1947).

25 *U.S. v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999), *cert. denied*, 528 U.S. 1154 (2000).

26 IRC § 7525(b); *Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009).

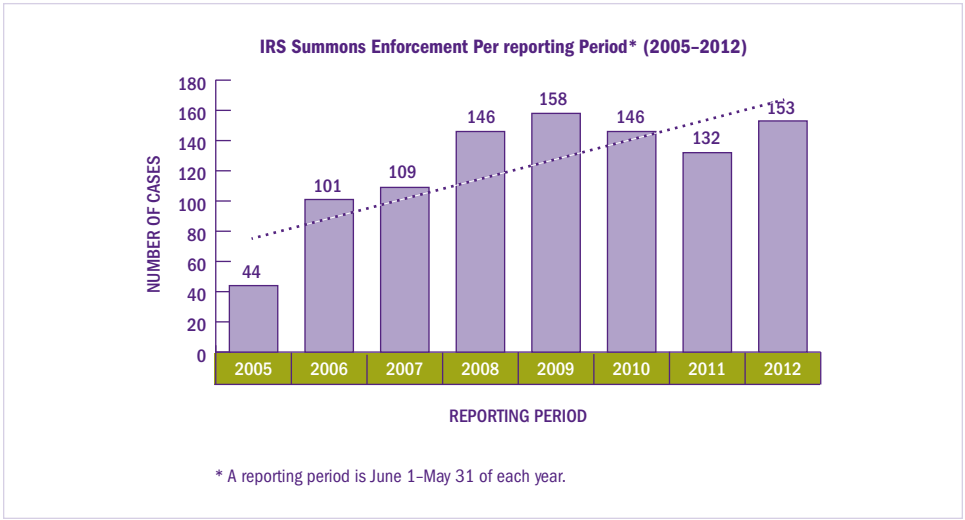
27 IRC § 7525(b).

28 IRC § 6662(d)(2)(C)(ii).

ANALYSIS OF LITIGATED CASES

Summons enforcement has appeared as a Most Litigated Issue in the National Taxpayer Advocate's Annual Report to Congress every year since 2005. At that time, we identified only 44 cases but predicted the number would rise as the IRS became more aggressive in its enforcement initiatives. The volume of identified cases has risen from 101 during the reporting period ending on May 31, 2006 to 153 during this year's reporting period as shown in Figure 3.1.1 below. A detailed list of these cases appears in Table 1 of Appendix III.

FIGURE 3.1.1, Summons Enforcement Cases, 2005–2012



The IRS prevailed in full in 152 cases, and one resulted in a split decision. Taxpayers did not prevail in full in any case. Attorneys represented taxpayers in 29 cases, while taxpayers appeared *pro se* (*i.e.*, without counsel) in 123 cases.[29] One-hundred and fifteen cases involved individual taxpayers, while the remaining 38 involved business taxpayers, including sole proprietorships (16 of whom had representation). The arguments the litigants raised against IRS summonses generally fell into the following categories:

***Powell* Requirements:** Taxpayers frequently argued that the IRS did not meet one or more of the *Powell* requirements, but such arguments met with little success. This outcome is due in large part to the substantial burden placed upon the taxpayer to rebut the IRS's *prima facie*[30] showing that the summons should be enforced. The United States Court of

29 In the remaining case, *In re Does*, 108 A.F.T.R.2d (RIA) 7499 (E.D. Cal. 2011), the United States commenced an *ex parte* proceeding seeking court approval of a "John Doe" summons.

30 "*Prima facie*" means "at first sight, on first appearance but subject to further review or evidence." *Black's Law Dictionary* (9th ed. 2009).

Appeals for the Eighth Circuit has described the IRS's burden here to be slight, and the taxpayer's burden to be great.[31]

Criminal Referral: The IRS may issue summonses for the purpose of investigating a possible criminal offense, so long as the matter has not yet been referred to the DOJ.[32] Many taxpayers argued that because the IRS issued the summons pursuant to a possible criminal investigation, it violated the IRC § 7602(d) restriction on issuing a summons after referring the matter to the DOJ. However, the courts were careful to distinguish between a *referral* to the DOJ, which prevents the IRS from issuing a summons, and a *criminal investigation* by the IRS, which does not.[33]

Constitutional Arguments: Taxpayers asserted several constitutional arguments, without success. For example, courts have long stated that taxpayers cannot use the Fourth Amendment as a defense against a third-party summons.[34] Although the courts also rejected blanket assertions of Fifth Amendment protection,[35] taxpayers may have valid Fifth Amendment claims regarding specific documents or testimony.[36] Even though a taxpayer may assert the claim on behalf of himself or herself, he or she may not assert it on behalf of a business entity.[37] Courts have also rejected First Amendment arguments against summons enforcement. In one case, the court rejected a taxpayer's claim that his First Amendment rights were violated by IRS agents who were attempting to "deter or chill respondent's speaking out against harassing agent conduct."[38] Courts also rejected taxpayers' arguments that summons enforcement violated their rights under federal privacy laws.[39] Some taxpayers argued, without success, that the summonses issued were unconstitutionally overbroad.[40]

In limited circumstances, the IRS can issue a summons even if the name of the taxpayer under investigation is unknown,[41] *i.e.,* a "John Doe" summons.[42] In *In re: Does*,[43] the court

31 *U.S. v. Claes*, 747 F.2d 491, 494 (8th Cir. 1984).

32 *See, e.g., Peterson v. U.S.*, 109 A.F.T.R.2d (RIA) 1099 (D. Neb. 2012).

33 *See, e.g., Gonzalez v. U.S.*, 108 A.F.T.R.2d (RIA) 6652 (N.D. Ill. 2011).

34 *Lewis v. U.S.*, 109 A.F.T.R.2d (RIA) 1756 (E.D. Cal. 2012) (citing *Donaldson v. U.S.*, 400 U.S. 517, 522 (1971)).

35 *U.S. v. Sakai*, 107 A.F.T.R.2d (RIA) 2757 (D. Haw. 2011), *adopted by* 107 A.F.T.R.2d (RIA) 2765 (D. Haw. 2011).

36 *U.S. v. Schleweis*, 108 A.F.T.R.2d (RIA) 5297 (D. Colo. 2011), *appeal docketed*, No. 11-1329 (10th Cir. July 20, 2011).

37 *Id*.

38 *Canatella v. U.S.*, 108 A.F.T.R.2d (RIA) 5256 (N.D. Cal. 2011), *appeal docketed*, No. 11-2175 (9th Cir. Aug. 5, 2011).

39 *See, e.g., Talbot v. U.S.*, 108 A.F.T.R.2d (RIA) 5309 (D. Ariz. 2011), *appeal docketed*, No. 11-17166 (9th Cir. Sept. 13, 2011); *Jordan v. U.S.*, 108 A.F.T.R.2d (RIA) 6821 (S.D. Ohio 2011), *adopted by* 108 A.F.T.R.2d (RIA) 6824 (S.D. Ohio 2011).

40 *See, e.g., U.S. v. Lyons*, 107 A.F.T.R.2d (RIA) 2733 (E.D. Tex. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2732 (E.D. Tex. 2011); *U.S. v. Lano Equip., Inc.*, 2012 U.S. Dist. LEXIS 77900 (D. Minn. 2012), *adopted by* 2012 U.S. Dist. LEXIS 77392 (D. Minn. 2012).

41 IRC § 7609(f).

42 The court must approve a "John Doe" summons prior to issuance. In order for the court to approve the summons, the United States commences an *ex parte* proceeding. The United States must establish during the proceeding that its investigation relates to an ascertainable class of persons; it has a reasonable basis for the belief that these unknown taxpayers may have failed to comply with the tax laws; and it cannot obtain the information from another readily available source. IRC § 7609(f).

43 108 A.F.T.R.2d (RIA) 7499 (E.D. Cal. 2011).

granted the IRS's revised *ex parte* petition to serve a "John Doe" summons on the California Board of Equalization, which it previously denied without prejudice.[44] The IRS summons sought to identify, from California state records, a class of taxpayers who had made non-spousal transfers of real property to related parties for little or no consideration.[45] The court concluded that the IRS met all three elements of IRC § 7609(f) and held that the Tenth and Eleventh Amendments to the Constitution did not prohibit the issuance of a "John Doe" summons on a state.[46] The court reasoned that because the Tenth Amendment does not prevent a federal grand jury from subpoenaing a state, it cannot bar an IRS summons. The court also concluded that the Eleventh Amendment only provides states sovereign immunity when the state is being sued by private individuals, not when the state is sued by the United States.[47]

In *Miccosukee Tribe of Indians of Florida v. United States*, the taxpayer, the Miccosukee Tribe of Indians (the Tribe), argued that tribal sovereign immunity barred the United States from issuing summonses to financial institutions to obtain the Tribe's financial records.[48] In that case, the IRS issued summonses to several financial institutions seeking the Tribe's records to determine whether the Tribe had properly complied with its federal tax reporting and withholding obligations. The Tribe argued that tribal sovereign immunity barred the United States from issuing the summonses. The court rejected the claim, holding that tribal sovereign immunity does not bar suits by the United States and cannot be invoked to "prevent the federal government from exercising its superior sovereign power."[49]

Privilege: Courts generally rejected claims of attorney-client privilege. In *Dougan v. United States*,[50] the court rejected the taxpayer's argument that the attorney-client privilege protected his bank records from being summoned. The taxpayer, a personal injury attorney, argued that to examine his bank records would be tantamount to violating his clients' confidences.[51] The court concluded that the bank records did not constitute confidential communications between an attorney and his clients, and thus were not subject to the attorney-client privilege.[52] In a few cases, taxpayers asserted blanket claims of attorney-client

44 *See In re: Does*, 107 A.F.T.R.2d (RIA) 2318 (E.D. Cal. 2011). The earlier proceeding in this case was included in the case table in the National Taxpayer Advocate's 2011 Annual Report to Congress at 701.

45 Most gifts above a certain value must be reported on a Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*. IRC § 6019. Two legal commentators believe that this litigation reveals a major ongoing IRS compliance initiative in the area of unfiled gift tax returns. *See* Scott D. Michel and Beth Shapiro Kaufman, *Unreported Gifts of Real Property: Time for a Voluntary Disclosure?*, 132 Tax Notes 513 (2011).

46 *In re: Does*, 108 A.F.T.R.2d (RIA) 7499 (E.D. Cal. 2011).

47 *Id.*

48 108 A.F.T.R.2d (RIA) 5572 (S.D. Fla. 2011), *appeal docketed*, No. 11-14825 (11th Cir. Oct. 17, 2011), *motion to stay pending appeal denied by* 108 A.F.T.R.2d (RIA) 7072 (S.D. Fla. 2011).

49 108 A.F.T.R.2d (RIA) 5572 (S.D. Fla. 2011), (citing *Fla. Paraplegic Assoc'n v. Miccosukee Tribe of Indians*, 166 F.3d 1126, 1127 (11th Cir. 1999)), *appeal docketed*, No. 11-14825 (11th Cir. Oct. 17, 2011), *motion to stay pending appeal denied by* 108 A.F.T.R.2d (RIA) 7072 (S.D. Fla. 2011).

50 108 A.F.T.R.2d (RIA) 5847 (E.D. Cal. 2011), *adopted by* 108 A.F.T.R.2d (RIA) 6663 (E.D. Cal. 2011).

51 *Id.*

52 *Id.*

privilege but failed to identify specific communications the privilege covered.[53] The courts required the taxpayers to produce logs describing which documents they believed were protected.[54]

In addition to the attorney-client privilege, taxpayers may use the tax practitioner privilege under IRC § 7525 or the work-product privilege as defenses to summons enforcement. The tax practitioner privilege exists to the extent the communication would be considered privileged if it took place between a taxpayer and an attorney and its purpose was obtaining tax advice from a federally authorized tax practitioner.[55]

In *United States v. PricewaterhouseCoopers, LLP*, the court considered the applicability of the tax practitioner privilege.[56] In that case, a husband and wife had their returns prepared by PricewaterhouseCoopers (PWC). The IRS issued a summons to PWC seeking the documents used to prepare the returns. Upon learning about the summons, the taxpayers retained an attorney, who wrote to PWC stating that the firm should not disclose the information because it was privileged under IRC § 7525. PWC sent the taxpayers copies of all documents in its possession and requested that they identify any privileged ones. However, the taxpayers did not identify purportedly confidential documents, nor did they intervene or move to quash the summonses in the enforcement proceeding. While PWC did not object to enforcement of the summonses based on privilege or otherwise, it requested the protection of a court order requiring production in light of the letter it had received from the taxpayers' attorney.[57] The court held that the taxpayers had waived any privilege by failing to intervene or file a move to quash in the proceeding. The court noted further that even had the taxpayers properly asserted a privilege, it would not have been upheld in this case, as there was no indication that the documents contained "confidential tax advice or other communications."[58]

Finally, in one case, a court rejected a taxpayer's work-product objection to summons enforcement. In *United States v. Sakai*,[59] the court concluded that under a totality of the circumstances, the taxpayers' amended returns were not prepared "because of" litigation, since the IRS had not yet begun its audit when they were prepared, and so the taxpayer's accountant could not invoke the privilege to avoid testifying about the returns.

53 *U.S. v. Sakai*, 107 A.F.T.R.2d (RIA) 2757 (D. Haw. 2011), *adopted by* 107 A.F.T.R.2d (RIA) 2765 (D. Haw. 2011); *Amabile, U.S. v.*, 2011 U.S. Dist. LEXIS 146350 (E.D. Pa. 2011).

54 *Id.*

55 IRC § 7525(a)(1).

56 2012 U.S. Dist. LEXIS 64517 (D. Minn. 2012), *adopting* 2012 U.S. Dist. LEXIS 63808 (D. Minn. 2012).

57 *Id.*

58 *Id.*

59 107 A.F.T.R.2d (RIA) 2757 (D. Haw. 2011), *adopted by* 107 A.F.T.R.2d (RIA) 2765 (D. Haw. 2011).

The IRS prevailed in all 39 of the cases involving motions to quash summonses, in part because the courts lacked jurisdiction to hear the cases. The courts dismissed these cases for lack of jurisdiction for the following reasons:

Lack of Jurisdiction Due to Procedural Requirements: The United States is immune from suit unless Congress has expressly waived its sovereign immunity.[60] Since a motion to quash service of an IRS summons is a suit against the United States, a court has jurisdiction only when Congress has expressly waived sovereign immunity.[61] When a taxpayer wishes to challenge an IRS summons issued to a third party, federal law sets forth the exclusive method by which a taxpayer may proceed.[62] A taxpayer may initiate a proceeding in the U.S. District Court for the district in which the third party resides, no later than 20 days from the date the notice of summons was given.[63] Accordingly, courts have strictly construed IRC § 7609 when determining whether sovereign immunity has been waived.[64] For example, a court dismissed a *pro se* taxpayer's motion to quash for lack of jurisdiction, because the taxpayer filed the motion 11 days after the 20-day limit had expired.[65] Another court held that it lacked subject matter jurisdiction over a petition to quash a third-party tax summons, where the third parties neither resided nor were found within the jurisdiction of the District Court.[66]

In *Day v. United States*,[67] the government served summonses upon two banks to investigate a taxpayer who asserted that he was a *bona fide* resident of the United States Virgin Islands (USVI) and was not required to file a U.S. tax return. The taxpayer moved to quash the summons, arguing that the IRS acted in bad faith, because it essentially eliminated the statute of limitations for USVI residents with gross income exceeding $75,000 for taxable years ending before December 31, 2006.[68] The court rejected this argument and held that substantive challenges to the statutory period of limitation on assessments do not constitute a defense to an IRS summons.[69]

Lack of Jurisdiction Due to Notice Requirements: Courts denied several motions to quash because the parties contesting the summonses were not entitled to notice of the summonses due to one of the IRC § 7609(c) exceptions, and therefore lacked standing to contest their

60 *U.S. v. Dalm*, 494 U.S. 596, 608 (1990).

61 *Grant v. U.S.*, 2012 U.S. Dist. LEXIS 2972 (C.D. Cal. 2012).

62 IRC § 7609(b)(2)(A). See *Lewis v. U.S.*, 109 A.F.T.R.2d (RIA) 1756 (E.D. Cal. 2012).

63 IRC § 7609(b)(2)(A); *Mayberry v. U.S.*, 108 A.F.T.R.2d (RIA) 5497 (E.D.N.C. 2011).

64 *Dunich-Kolb v. U.S.*, 108 A.F.T.R.2d (RIA) 5165 (D.N.J. 2011).

65 Mayberry v. U.S., 108 A.F.T.R.2d (RIA) 5497 (E.D.N.C. 2011).

66 *Williams v. U.S.*, 453 Fed. Appx. 532 (5th Cir. 2011) (per curiam), *aff'g* 107 A.F.T.R.2d (RIA) 1453 (N.D. Tex. 2011).

67 108 A.F.T.R.2d (RIA) 6266 (D. Colo. 2011).

68 For a detailed discussion of the statutory period of limitations issue pertaining to USVI residents, see National Taxpayer Advocate 2009 Annual Report to Congress 391-399 (Legislative Recommendation: *Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers*). The taxpayer also cited the 2009 Annual Report to Congress for the proposition that, in his opinion, the IRS had acted in bad faith.

69 108 A.F.T.R.2d (RIA) 6266 (D. Colo. 2011). The court also concluded that its reasoning would not change even if the taxpayer were to challenge the statutory period for assessment on constitutional grounds.

validity.[70] In *Viewtech, Inc. v. United* States,[71] the court concluded that neither an individual taxpayer, nor a corporation in which he had a sufficient interest, was entitled to notice, so neither had standing to quash the summons.

CONCLUSION

The IRS may issue a summons to obtain information needed to determine whether a tax return is correct or if a return should have been filed, to ascertain a taxpayer's tax liability, or to collect a liability.[72] Accordingly, the IRS may request documents and testimony from taxpayers who have failed to provide that information voluntarily. Taxpayers and third parties rarely succeed in contesting IRS summonses due to the significant burden of proof and strict procedural requirements. Thus, taxpayers seldom challenge summons enforcement at the appellate level.[73] It appears that as the IRS employs a more aggressive enforcement policy, it will continue to rely heavily on the summons enforcement tool, and the courts will continue to see these cases.

70 IRC § 7609(c)(2)(D)(i); *Viewtech, Inc. v. U.S.*, 653 F.3d 1102 (9th Cir. 2011), *aff'g* 104 A.F.T.R.2d (RIA) 7101 (S.D. Cal. 2009).

71 *Id.*

72 IRC § 7602(a).

73 Appeals were docketed in only 13 of the 153 cases reviewed herein, and five have since been dismissed.

MLI #2

Accuracy-Related Penalty Under IRC §§ 6662(b)(1) and (2)

SUMMARY

Internal Revenue Code (IRC) § § 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations caused an underpayment of tax, or if an underpayment exceeded a computational threshold called a substantial understatement. IRC § 6662(b) also authorizes the IRS to impose five other accuracy-related penalties.[1] We did not analyze these other accuracy-related penalties because during our review period of June 1, 2011, through May 31, 2012, taxpayers litigated these penalties less frequently than the negligence and substantial understatement penalties.

PRESENT LAW

The amount of an accuracy-related penalty equals 20 percent of the portion of the underpayment attributable to the taxpayer's negligence or disregard of rules or regulations or to a substantial understatement.[2] The IRS may assess penalties under both IRC § 6662(b)(1) and IRC § 6662(b)(2), but the total penalty rate cannot exceed 20 percent (*i.e.*, the penalties are not "stackable").[3] Generally, taxpayers are not subject to the accuracy-related penalty if they establish that they had reasonable cause for the underpayment and acted in good faith.[4] In addition, a taxpayer will be subject to the negligence component of the penalty only on the portion of the underpayment attributable to negligence. For example, if a taxpayer wrongly reports multiple items of income, some errors may be justifiable mistakes while others might be the result of negligence; the penalty applies only to the latter.

Negligence

The IRS may impose the IRC § 6662(b)(1) negligence penalty if it concludes that a taxpayer's negligence or disregard of the rules or regulations caused the underpayment. Negligence is defined as "any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard."[5] Negligence includes a failure to keep adequate books and records or to

1 IRC § 6662(b)(3) authorizes a penalty for any substantial valuation misstatement for income taxes; IRC § 6662(b)(4) authorizes a penalty for any substantial overstatement of pension liabilities; IRC § 6662(b)(5) authorizes a penalty for any substantial valuation understatement of estate or gift taxes; IRC § 6662(b)(6) authorizes a penalty when the IRS disallows the tax benefits claimed by the taxpayer when the transaction lacks economic substance; and IRC § 6662(b)(7) authorizes a penalty for any undisclosed foreign financial asset understatement. Note, however, that there has been some significant litigation involving IRC § 6662(h) (the increased penalty in the case of a gross valuation misstatement). For additional discussion of that litigation, see *Significant Cases, supra*.

2 IRC § 6662(b)(1) (negligence/disregard of rules or regulations) and IRC § 6662(b)(2) (substantial understatement).

3 Treas. Reg. § 1.6662-2(c). The penalty rises to 40 percent if any portion of the underpayment is due to a "gross valuation misstatement." *See* IRC § 6662(h)(1).

4 IRC § 6664(c)(1).

5 IRC § 6662(c).

substantiate items that gave rise to the underpayment.[6] Strong indicators of negligence include instances where a taxpayer failed to report income on a tax return that a payor reported on an information return as defined in IRC § 6724(d)(1),[7] or failed to make a reasonable attempt to ascertain the correctness of a deduction, credit, or exclusion.[8] The IRS can also consider various other factors in determining whether the taxpayer's actions were negligent.[9]

Substantial Understatement

Generally, an "understatement" is the difference between (1) the correct amount of tax and (2) the tax reported on the return, reduced by any rebate.[10] Understatements are reduced by the portion attributable to (1) an item for which the taxpayer had substantial authority, or (2) any item for which the taxpayer, in the return or an attached statement, adequately disclosed the relevant facts affecting the item's tax treatment and the taxpayer had a reasonable basis for the tax treatment.[11] For individuals, the understatement of tax is substantial if it exceeds the greater of $5,000 or ten percent of the tax that must be shown on the return.[12] For corporations (other than S corporations or personal holding companies), an understatement is substantial if it exceeds the lesser of ten percent of the tax required to be shown on the return (or, if greater, $10,000), or $10,000,000.[13]

For example, if the correct amount of tax is $10,000 and an individual taxpayer reported $6,000, the substantial understatement penalty under IRC § 6662(b)(2) would not apply because although the $4,000 shortfall is more than ten percent of the correct tax, it is less than the fixed $5,000 threshold. Conversely, if the same individual reported a tax of $4,000, the substantial understatement penalty would apply because the $6,000 shortfall is more than $5,000, which is the greater of the two thresholds.

Reasonable Cause

The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.[14] A reasonable cause

6 Treas. Reg. § 1.6662-3(b)(1).

7 IRC § 6724(d)(1) defines an information return by cross-referencing various other sections of the Code that define information returns (*e.g.*, IRC§ 6724(d)(1)(A)(ii) cross-references IRC § 6042(a)(1) for reporting of dividend payments).

8 Treas. Reg. § 1.6662-3(b)(1)(i)-(ii).

9 These factors include the taxpayer's history of noncompliance; the taxpayer's failure to maintain adequate books and records; actions taken by the taxpayer to ensure the tax was correct; and whether the taxpayer had an adequate explanation for underreported income. Internal Revenue Manual (IRM) 4.10.6.2.1 (May 14, 1999).

10 IRC § 6662(d)(2)(A)(i)-(ii).

11 IRC § 6662(d)(2)(B)(i)-(ii). No reduction is permitted, however, for any item attributable to a tax shelter. *See* IRC § 6662(d)(2)(C)(i).

12 IRC § 6662(d)(1)(A)(i)-(ii).

13 IRC § 6662(d)(1)(B)(i)-(ii).

14 IRC § 6664(c)(1).

determination takes into account all of the pertinent facts and circumstances.[15] Generally, the most important factor is the extent of the taxpayer's effort to determine the proper tax liability.[16]

Penalty Assessment and the Litigation Process

In general, the IRS proposes the accuracy-related penalty as part of its examination process[17] and through its Automated Underreporter (AUR) computer system.[18] Before a taxpayer receives a notice of deficiency, he or she has opportunities to engage the IRS on the merits of the penalty.[19] Once the IRS concludes an accuracy-related penalty is warranted, it must follow the same deficiency procedures it uses with other assessments (*i.e.*, IRC §§ 6211-6213).[20] Thus, the IRS must send a notice of deficiency with the proposed adjustments and inform the taxpayer that he or she has 90 days to petition the United States Tax Court to challenge the assessment.[21] Alternatively, taxpayers may seek judicial review through refund litigation.[22] Under certain circumstances, a taxpayer can request an administrative appeal of IRS collection procedures (and the underlying liability) through a Collection Due Process (CDP) hearing.[23]

15 Treas. Reg. § 1.6664-4(b)(1).

16 *Id*.

17 IRM 4.10.6.2(1) (May 14, 1999) ("assessment of penalties should be considered throughout the audit"). *See also* IRM 20.1.5.3(1)-(2) (Jan. 24, 2012).

18 The AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payors reported via Form W-2, Form 1099, and other information returns. *See* IRM 4.19.2 (July 31, 2012). IRC § 6751(b)(1) provides the general rule that IRS employees must have written supervisory approval before assessing any penalty. However, IRC § 6751(b)(2)(B) allows an exception for situations where the IRS can calculate a penalty automatically "through electronic means." The IRS interprets this exception as allowing it to use its AUR system to propose the substantial understatement and negligence components of the accuracy-related penalty without human review. If a taxpayer responds to an AUR-proposed assessment, the IRS first involves its employees at that point to determine whether the penalty is appropriate. If the taxpayer does not respond timely to the notice, the computers automatically convert the proposed penalty to an assessment. *See* National Taxpayer Advocate 2007 Annual Report to Congress 259 ("Although automation has allowed the IRS to more efficiently identify and determine when such underreporting occurs, the IRS's over-reliance on automated systems rather than personal contact has led to insufficient levels of customer service for taxpayers subject to AUR. It has also resulted in audit reconsideration and tax abatement rates that are significantly higher than those of all other IRS examination programs.").

19 For example, when the IRS proposes to adjust a taxpayer's liability, including additions to tax such as the accuracy-related penalty, it typically sends a notice ("30-day letter") of proposed adjustments to the taxpayer. A taxpayer has 30 days to contest the proposed adjustments to the IRS Office of Appeals, during which time he or she may raise issues related to the deficiency, including any reasonable cause defense to a proposed penalty. If the issue is not resolved after the 30-day letter, the IRS sends a statutory notice of deficiency ("90-day letter") to the taxpayer. *See* IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree* (Jan. 1999); IRS Pub. 3498, *The Examination Process* (Nov. 2004).

20 IRC § 6665(a)(1).

21 IRC § 6213(a). A taxpayer has 150 days instead of 90 to petition the Tax Court if the notice of deficiency is addressed to the taxpayer outside the United States.

22 Taxpayers may litigate an accuracy-related penalty by paying the tax liability (including the penalty) in full, filing a timely claim for refund, and then instituting a refund suit in the appropriate United States District Court or the Court of Federal Claims. 28 U.S.C. § 1346(a)(1); IRC § 7422(a); *Flora v. United States*, 362 U.S. 145 (1960) (requiring full payment of tax liabilities as a prerequisite for jurisdiction over refund litigation).

23 IRC §§ 6320 and 6330 provide for due process hearings in which a taxpayer may raise a variety of issues including the underlying liability, provided the taxpayer did not receive a statutory notice of deficiency or did not otherwise have an opportunity to dispute such liability. IRC §§ 6320(c), 6330(c)(2).

Burden of Proof

In court proceedings, the IRS bears the initial burden of production regarding the accuracy-related penalty.[24] The IRS must first present sufficient evidence to establish that the penalty is warranted. The burden of proof then shifts to the taxpayer to establish any exception to the penalty, such as reasonable cause.[25]

ANALYSIS OF LITIGATED CASES

We identified 117 opinions issued between June 1, 2011 and May 31, 2012 where taxpayers litigated the negligence/disregard of rules or regulations or substantial understatement components of the accuracy-related penalty. The IRS prevailed in full in 77 cases (66 percent), the taxpayers prevailed in full in 29 cases (25 percent), and 11 cases (nine percent) resulted in split decisions. Table 2 in Appendix III provides a detailed list of these cases.

Taxpayers appeared *pro se* (without representation) in 53 of the 117 cases (45 percent) and convinced the court to dismiss or reduce the penalty in 14 (26 percent) of those cases. Represented taxpayers fared much better, achieving full or partial relief from the penalty in 26 of their 64 cases (41 percent).

In some cases, the court found taxpayers liable for the accuracy-related penalty but failed to clarify whether it was for negligence under § 6662(b)(1), or a substantial understatement of tax under § 6662(b)(2), or both.[26] Regardless of the subsection at issue, the analysis of reasonable cause is the same. Therefore, we have combined our analyses of reasonable cause for the negligence and substantial understatement cases.

Reasonable Cause

Adequacy of Records and Substantiation of Deductions to Show Reasonable Cause and as Proof of Taxpayer's Good Faith

Taxpayers are required to maintain records sufficient to establish the amount of gross income, deductions, and credits claimed on a return.[27] Taxpayers were most successful in establishing a defense for an asserted underpayment when they produced adequate records or proved they made a reasonable attempt to comply with the requirements of the law. For example, in *Miller v. Commissioner,*[28] the taxpayers engaged in rental real estate activities and sought to deduct losses associated with those activities. The IRS disallowed the losses,

24 IRC § 7491(c) provides that "the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title."

25 IRC § 7491(a). *See also* Tax Court Rule 142(a).

26 *See e.g., Crane v. Comm'r*, T.C. Memo. 2011-256 (IRS assessed accuracy-related penalties against taxpayers for both § 6662(b)(1) understatement of tax and (b)(2) negligence, but the Tax Court ultimately held them liable for "the accuracy-related penalty under section 6662(a)," (without identifying which subsection applied); *compare with Woodsum v. Comm'r*, 136 T.C. 585, 590 (2011) (IRS assessed accuracy-related penalties under both § 6662(b)(1) and (b)(2); however, once the IRS established that the taxpayers had substantially understated their income under § 6662(b)(2), the court declined to consider the negligence claim).

27 IRC § 6001; Treas. Reg. § 1.6001-1(a).

28 T.C. Memo. 2011-219.

believing the taxpayers' rental activities were passive activities.[29] While rental activity is generally treated as a passive activity, the taxpayers adequately established through contemporaneous records and credible testimony that the husband qualified as a real estate professional and that he and his wife materially participated in renting two of their six properties, so the deductions attributable to those activities were not subject to the passive activity limitation of IRC § 469. In contrast, the court found that the taxpayers' participation in the remaining four properties was passive, and therefore sustained the IRS's disallowance of losses with respect to the real estate activities at those properties. The court did not, however, impose the accuracy-related penalty for a substantial understatement of income tax because the taxpayers acted with reasonable cause and in good faith. The taxpayers met their burden of proof by establishing that the husband qualified as a real estate professional and by providing extensive records of their rental real estate activities, including contemporaneous timesheets showing active participation with respect to two of their properties.[30]

Other taxpayers did not present sufficient evidence to indicate they acted with reasonable cause or in good faith, so their accuracy-related penalties were sustained. For example, in *Esrig v. Commissioner*,[31] the Tax Court found a husband and wife liable for all accuracy-related penalties because they kept generally inadequate books and records and failed to adequately substantiate various items, including net operating loss carryovers, office expenses and certain itemized business deductions. Similarly, in *Linzy v. Commissioner*,[32] a professional tax return preparer owned an apartment building, part of which was used to operate her business. The Tax Court found that the taxpayer failed to substantiate deductions for contract labor, medical expenses, and most of her charitable contributions. In addition, she improperly deducted numerous payments that should have been depreciated as required by law. Therefore, the Tax Court found no reasonable cause or good faith for the underpayments and upheld the accuracy-related penalty.

Reliance on Advice of a Tax Professional as Reasonable Cause

Another commonly litigated question was whether reliance on a tax professional established reasonable cause. The taxpayer's education, sophistication, and business experience are relevant in determining whether his or her reliance on tax advice was reasonable.[33] To prevail, a taxpayer must establish that:

1. The adviser was a competent professional who had sufficient expertise to justify reliance;
2. The taxpayer provided necessary and accurate information to the adviser; and

29 IRC § 469(a)(1) provides that passive activity losses shall be disallowed.

30 *Miller*, T.C. Memo. 2011-219.

31 T.C. Memo. 2012-38.

32 T.C. Memo. 2011-264.

33 Treas. Reg. § 1.6664-4(c)(1). *See also* IRM 20.1.5.6.1(6) (Jan. 24, 2012).

3. The taxpayer actually relied in good faith on the adviser's judgment.[34]

In *Butler v. Commissioner*,[35] the IRS imposed accuracy-related penalties on taxpayers due to income tax deficiencies for two years related to the donation of conservation easements. The taxpayers presented credible evidence that, throughout the process of donating the easements and preparing their tax returns, they relied upon their longtime attorney and accountant, and engaged a real estate firm specializing in conservation conveyances, which helped them select qualified and experienced appraisers of conservation easements. The court agreed that the taxpayers had reasonable cause and acted in good faith with respect to their underpayments and held them not liable for accuracy-related penalties.

Several cases were decided against the taxpayer, however, where the taxpayer failed to establish that the tax professional met all of the three above-mentioned criteria. In *Kirman v. Commissioner*,[36] the taxpayer failed to establish that his tax preparer was a "competent professional who had sufficient expertise to justify reliance."[37] While the preparer had an accounting degree, he was not a CPA and only prepared tax returns "on the side."[38] Second, the taxpayer failed to establish that he provided all relevant and necessary information to his return preparer. Finally, "unconditional reliance on a preparer or adviser does not always constitute reasonable reliance."[39] The taxpayer relied entirely on his return preparer and did not examine or sign the original return. For all these reasons, the Tax Court found taxpayer's reliance on his tax preparer unreasonable and sustained the accuracy-related penalty.

Reasonable cause was also found lacking when the tax professional had an inherent conflict of interest. In *Hristov v. Commissioner*,[40] the taxpayers (a husband and wife) met with a promoter who told them they could reduce their tax liability by using an IRC § 419 welfare benefit plan[41] and a defined benefit plan. The taxpayers claimed deductions for their IRC § 419 plan contributions and defined benefit contributions, which the IRS disallowed during an audit. Before entering into the transaction, the taxpayers met with their tax return preparer, who informed them she had never worked with an IRC § 419 welfare benefit plans or defined benefit plans before. The Tax Court rejected the taxpayers' reasonable reliance argument because the taxpayers knew their return preparer lacked the necessary knowledge and experience in the relevant areas of federal tax law; they failed to show that they provided her with all the necessary and accurate information to prepare the returns;

34 *Neonatology Associates, P.A. v. Comm'r*, 115 T.C. 43, 99 (2000) (citations omitted), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

35 T.C. Memo. 2012-72.

36 T.C. Memo. 2011-128.

37 *Id*.

38 *Id*.

39 *Id.*

40 T.C. Memo. 2012-147.

41 IRC §§ 419 and 419A allow employers to make tax deductible contributions to welfare benefit plans in order to provide medical and life insurance benefits to their employees or their beneficiaries.

and their reliance on the promoter of the tax shelter was not reasonable due to his conflict of interest. The taxpayers knew, or should have known, that any advice received from the promoter was not independent because the promoter benefited financially from their use of his services. It was also unreasonable for the taxpayers to rely on advice that would seem to a reasonable person to be "too good to be true."[42]

Another case where reliance on professional advice was found insufficient to constitute reasonable cause involved taxpayers who failed to examine the prepared return adequately to ensure its accuracy. In *Woodsum v. Commissioner*,[43] married taxpayers retained a firm to prepare their joint federal return. The taxpayers gave the firm over 160 information returns they had received from third-party payors, including a Form 1099-MISC, *Miscellaneous Income*, reporting a long-term capital gain of $3.4 million.[44] The firm prepared a 115-page return that reported $29.2 million of adjusted gross income but omitted the $3.4 million. While the cause of the omission was never determined, the taxpayers contend it was a simple clerical error or oversight by the return preparers, and argued that they should not be held liable for an accuracy-related penalty because they were relying on professional advice. The Tax Court disagreed. The third prong of the *Neonatology* test described above is that "the taxpayer actually relied in good faith on the adviser's *judgment*."[45] The Court explained that, to rely on an advisor's judgment, the advisor must communicate some "analysis or conclusion" that would be characterized as "substantive advice."[46] There was no evidence that the return preparers used any "analysis" or "judgment" or that they were conveying a professional opinion to omit the $3.4 million. In signing the erroneously prepared return, the taxpayers were not following "substantive professional advice; they were instead unwittingly (they contend) perpetuating a clerical mistake."[47] Therefore, there was no merit to the defense of reliance on professional advice. "Even if all data is furnished to the preparer, the taxpayer still has a duty to read the return and make sure all income items are included."[48] The $3.4 million gain reported on the Form 1099-MISC should have appeared as a clear entry on Schedule D. Taxpayers showed insufficient evidence that they made a reasonable review of their return or that they put forth reasonable "effort to assess the . . . proper tax liability."[49]

42 *Hristov*, T.C. Memo. 2012-147.

43 136 T.C. 585 (2011).

44 *Id*. at 589. Although not the largest amount reported on the taxpayers' information returns, had it been included on the taxpayers' tax return, "it would have been the third largest long-term capital gain amount reported as a line item on Schedule D, Capital Gains and Losses." 136 T.C. 585 (2011) at 588.

45 *Neonatology Associates, P.A. v. Comm'r*, 115 T.C. 43, 99 (2000) at 344 (emphasis added) (citations omitted), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

46 *Woodsum*, 136 T.C. at 593 (quotations omitted). *See also* Treas. Reg. § 1.6664-4(c)(2).

47 *Woodsum*, 136 T.C. at 594.

48 *Id*. at 595 (quoting *Magill v. Comm'r*, 70 T.C. 465, 479-80 (1978), *aff'd*, 651 F.2d 1233 (6th Cir. 1981)).

49 *Id*. at 596 (quoting Treas. Reg. § 1.6664-4(b)(1)).

Characterization of Settlement Income

We reviewed multiple cases decided this past year where accuracy-related penalties were imposed on taxpayers for not reporting income received from settlements.[50] IRC § 104(a)(2) excludes from gross income "the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal *physical* injuries or *physical* sickness."[51] In each of the cases, the courts determined that no portion of any of the settlements was attributable to physical injuries or physical sickness, so the entire amount of each settlement was properly includible in gross income. However, the courts did not impose accuracy-related penalties in all of the cases. For example, in *Neri v. Commissioner*,[52] Mr. Neri was awarded $210,000 from an arbitrator in a proceeding involving claims he made against his former employer based on disability discrimination. Mr. Neri and his wife excluded the award from their gross income after consulting a tax attorney. After taking into account all the facts and circumstances, the Tax Court concluded that the taxpayers were not liable for the accuracy-related penalty.

In *McGowan v. Commissioner*,[53] the taxpayer filed a sexual harassment complaint against her employer and entered into a settlement agreement whereby the employer paid her three separate payments—one for attorneys' fees, one for lost income, and one for "physical injury caused by emotional distress."[54] The Tax Court upheld the IRS's determination that there was no evidence of a physical injury, and that "pursuant to the settlement agreement, [the taxpayer] received damages on account of her emotional distress and not as a result of 'a physical injury or physical sickness.'"[55] Therefore, the entire settlement amount was properly includible in gross income. The Tax Court declined to impose the accuracy-related penalty, however, because the taxpayer, who lacked knowledge and experience in tax law, reasonably believed that a portion of her settlement payment was due to "physical injury." Therefore, she acted in good faith in not reporting that amount on her income tax return.

In contrast, the court did sustain the IRS's imposition of the penalty in *Campbell v. Commissioner*.[56] In that case, the taxpayer was awarded $5.25 million in settlement of two whistleblower lawsuits against his former employer, a government contractor. The taxpayer did not include any of the settlement award in his gross income. In concluding that the imposition of the accuracy-related penalty was proper, the court noted that the taxpayer was a sophisticated taxpayer with a business degree in accounting "who chose not to consult a professional tax consultant in preparing his return."[57]

50 *See, e.g., Campbell v. Comm'r*, 658 F.3d 1255 (11th Cir. 2011), *aff'g* 134 T.C. 20 (2010); *Healthpoint, Ltd. v. Comm'r*, T.C. Memo. 2011-246.

51 IRC § 104(a)(2) (emphasis added).

52 T.C. Memo. 2012-71.

53 T.C. Memo. 2011-186.

54 *Id.* at 3.

55 *Id.* at 6.

56 658 F.3d 1255 (11th Cir. 2011), *aff'g* 134 T.C. 20 (2010).

57 *Id.* at 1260, *aff'g* 134 T.C. 20 (2010).

Improper Stacking

IRC § 6662(b) provides that the underpayment penalty will not apply to any portion of an underpayment on which a penalty is imposed under IRC § 6663.[58] We reviewed two cases that interpreted this anti-stacking provision. In both *Garavaglia v. Commissioner*[59] and *Garcia v. Commissioner*,[60] married couples filed joint tax returns, upon which the IRS imposed deficiencies and penalties. In both cases, the Tax Court found the husbands liable for fraud penalties under § 6663 for underpayments in connection with their respective businesses. Therefore, imposing the § 6662(b) accuracy-related penalty on the wives for the same underpayments would have resulted in "impermissible stacking,"[61] so the Tax Court found both wives not liable for the underpayment penalty.

CONCLUSION

Of the 117 cases we reviewed, the courts upheld the underlying tax deficiency, or portions of the deficiency, determined by the IRS in all cases. Nonetheless, in over one-third of the cases, the courts abated the accuracy-related penalties, partially or in full, where the taxpayer showed a reasonable and good-faith attempt to ascertain the correct amount of tax due. The most common bases for finding reasonable cause were maintenance of adequate records and reliance on competent and disinterested tax professionals. The courts also took into account the education, knowledge of tax law, and business experience of the taxpayers when determining the reasonableness of a given position. The IRS should take a closer look at the court's rationale in the cases where the taxpayer prevailed on the penalty issue. While the existence of reasonable cause is very fact-specific, the IRS may find lessons to be gained from those cases and incorporated into the Internal Revenue Manual and training materials, so that it does not unnecessarily impose on taxpayers the burden of having to litigate their positions in order to obtain penalty relief.

58 IRC § 6663 is referred to as the civil fraud penalty and provides as follows: "If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud."

59 T.C. Memo. 2011-228, *appeal docketed*, No. 12-1444 (6th Cir. Apr. 13, 2012).

60 T.C. Memo. 2012-155.

61 *Garcia*, T.C. Memo. 2012-155 at 34-35; *Garavaglia*, T.C. Memo. 2011-228 at 84, *appeal docketed*, No. 12-1444 (6th Cir. Apr. 13, 2012) (citing *Foxworthy, Inc. v. Comm'r*, T.C. Memo. 2009-203).

MLI #3

Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

SUMMARY

Collection Due Process (CDP) hearings were created by the IRS Restructuring and Reform Act of 1998 (RRA 98).[1] CDP hearings provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first lien with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.[2]

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court.[3] Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.[4]

Since 2003, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed for the National Taxpayer Advocate's Annual Report to Congress. The trend continues this year, with our review locating 116 opinions during the review period of June 1, 2011, through May 31, 2012.[5] Taxpayers prevailed in full in eight of these cases[6] (approximately seven percent) and in part in seven others (approximately six

1 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 Internal Revenue Code (IRC) §§ 6320(c) (lien) and 6330(c) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test.

3 IRC § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

4 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review upon a showing of "good cause," if the underlying tax liability is not at issue.

5 For a list of all of the cases reviewed, see Table 3 in Appendix III, *infra*.

6 *Dingman v. Comm'r*, T.C. Memo. 2011-116; *Fatehi v. Comm'r*, T.C. Summ. Op. 2012-26; *Rosenbloom v. Comm'r*, T.C. Memo. 2011-140; *Salahuddin v. Comm'r*, T.C. Memo. 2012-141; *Beeler v. Comm'r*, 434 Fed.Appx. 41 (2nd Cir. 2011), *vacating and remanding* T.C. Memo. 2009-266; *City Wide Transit, Inc. v. Comm'r*, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2nd Cir. Mar. 14, 2012); *Custom Stairs & Trim, Ltd, Inc. v. Comm'r*, T.C. Memo. 2011-155; *Leago v. Comm'r*, T.C. Memo. 2012-39.

percent).[7] Of the 15 taxpayers who prevailed in whole or in part, nine appeared *pro se*[8] and the six others were represented.[9]

The cases discussed below demonstrate that CDP serves an important function by providing taxpayers with a forum to raise legitimate issues before the IRS deprives them of property. Many of these decisions provide guidance on substantive issues. The Court imposed sanctions for inappropriate use of the process in eight of the 116 cases reviewed.

PRESENT LAW

Current law provides taxpayers an opportunity for independent review of an NFTL filed by the IRS, or of a proposed levy action.[10] As noted above, the purpose of CDP rights is to give taxpayers adequate notice of IRS collection activity and a meaningful hearing before the IRS deprives them of property.[11] The hearing allows taxpayers to raise issues relating to collection of the liability, including:

- Appropriateness of collection actions;[12]
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;[13]
- Appropriate spousal defenses;[14]
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a notice of deficiency or otherwise have an opportunity to dispute the liability;[15] and
- Any other relevant issue relating to the unpaid tax, the NFTL, or the proposed levy.[16]

A taxpayer cannot raise an issue considered at a prior administrative or judicial hearing if the individual participated meaningfully in that hearing or proceeding.[17]

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7 *Conway v. Comm'r*, 137 T.C. 209 (2011); *Karakaedos v. Comm'r*, T.C. Memo. 2012-53; *Lewis v. Comm'r*, T.C. Memo. 2012-138; *Semen v. Comm'r*, T.C. Memo. 2011-120; *Everett Assocs., Inc. v. Comm'r*, T.C. Memo. 2012-143; *Moreira v. Comm'r*, T.C. Memo. 2011-93; *Pacific West Fin. & Ins. Co. v. Comm'r*, T.C. Memo. 2011-143.

8 *Dingman v. Comm'r*, T.C. Memo. 2011-116; *Fatehi v. Comm'r*, T.C. Summ. Op. 2012-26; *Karakaedos v. Comm'r*, T.C. Memo. 2012-53; *Lewis v. Comm'r*, T.C. Memo. 2012-138; *Salahuddin v. Comm'r*, T.C. Memo. 2012-141; *Semen v. Comm'r*, T.C. Memo. 2011-120; *Custom Stairs & Trim, Ltd, Inc. v. Comm'r*, T.C. Memo. 2011-155; *Everett Assocs., Inc. v. Comm'r*, T.C. Memo. 2012-143; *Leago v. Comm'r*, T.C. Memo. 2012-39.

9 *Conway v. Comm'r*, 137 T.C. 209 (2011); *Rosenbloom v. Comm'r*, T.C. Memo. 2011-140; *Beeler v. Comm'r*, 434 Fed.Appx. 41 (2nd Cir. 2011), *vacating and remanding* T.C. Memo. 2009-266; *City Wide Transit, Inc. v. Comm'r*, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2nd Cir. Mar. 14, 2012); *Moreira v. Comm'r*, T.C. Memo. 2011-93; *Pacific West Fin. & Ins. Co. v. Comm'r*, T.C. Memo. 2011-143.

10 IRC §§ 6320 and 6330. See RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

11 Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. See *United States v. National Bank of Commerce*, 472 U.S. 713, 719-722 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

12 IRC § 6330(c)(2)(A)(ii).

13 IRC § 6330(c)(2)(A)(iii).

14 IRC § 6330(c)(2)(A)(i).

15 IRC § 6330(c)(2)(B).

16 IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

17 IRC § 6330(c)(4).

Procedural Collection Due Process Requirements

The IRS must provide a CDP notice to the taxpayer after it has filed the first NFTL or generally before its first intended levy for the particular tax and tax period.[18] The IRS must provide the notice not more than five business days after the day of filing the lien notice, or at least 30 days before the day of the proposed levy.[19] In a lien filing, the notice must inform the taxpayer of his or her right to request a CDP hearing within a 30-day period, which begins on the day after the end of the five-business-day period after the filing of the NFTL.[20] In the case of a levy, the notice must inform the taxpayer of his or her right to request a hearing within the 30-day period beginning on the day after the date on the CDP notice.[21]

Requesting a CDP Hearing

Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing within the applicable period.[22] Taxpayers who fail to timely request a hearing will be afforded an "equivalent hearing," which is similar to a CDP hearing, but without judicial review.[23] The Code and regulations require taxpayers to provide their reasons for requesting a hearing. The regulations ask taxpayers to use Form 12153, *Request for a Collection Due Process or Equivalent Hearing.* Failure to provide the basis may result in denial of a face-to-face hearing.[24] Taxpayers must request an equivalent hearing within the one-year period beginning the day after the five-business-day period following the filing of the NFTL, or in levy cases, within the one-year period beginning the day after the date of the CDP notice. [25]

Conduct of a CDP Hearing

The IRS generally will suspend levy action throughout a CDP hearing involving intent to levy, unless it determines that

- The collection of tax is in jeopardy;
- The collection resulted from a levy on a state tax refund; or

18 IRC § 6330(f) permits the IRS to levy without first giving a taxpayer a CDP notice in the following situations: the collection of tax is in jeopardy, a levy was served on a state to collect on a state tax refund, the levy is a disqualified employment tax levy; or the levy was served on a federal contractor. A disqualified employment tax levy is any levy to collect employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h).

19 IRC § 6320(a)(2) or § 6330(a)(2). The CDP notice can be provided to the taxpayer in person, left at the taxpayer's residence or dwelling, or sent by certified or registered mail (return receipt requested) to the taxpayer's last known address.

20 IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

21 IRC § 6330(a)(3)(B); Treas. Reg. § 301.6330-1(b)(1).

22 IRC §§ 6330(a)(3)(B) and 6320(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2) A-C1(ii) and 301.6330-1(c)(2) A-C1(ii).

23 Treas. Reg. §§ 301.6320-1(i)(2) Q&A-I16 and 301.6330-1(i)(2) Q&A-I16; *Orum v. Comm'r*, 123 T.C. 1 (2004); *Moorhous v. Comm'r*, 116 T.C. 263 (2001).

24 IRC §§ 6320(b)(1) and 6330(b)(1); Treas. Reg. §§ 301.6320-1(c)(2) A-C1, 301.6330-1(c)(2) A-C1, 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8. The regulations require the IRS to provide the taxpayer an opportunity to "cure" any defect in a timely filed hearing request, including providing a reason for the hearing. Form 12153 includes space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider, as well as examples of common reasons for requesting a hearing. *See* IRS Form 12153, *Request for Collection Due Process or Equivalent Hearing* (Mar. 2011).

25 Treas. Reg. §§ 301.6320-1(i)(2) A-17 and 301.6330-1(i)(2) A-17.

- The IRS has served a disqualified employment tax levy or a federal contractor levy.[26]

The IRS also suspends collection activity throughout any judicial review of Appeals' determination, unless the underlying tax liability is not at issue and the IRS can demonstrate good cause to resume collection activity.[27]

CDP hearings are informal. When a taxpayer requests a hearing with respect to both a lien and a proposed levy, Appeals will attempt to conduct one hearing.[28] Courts have determined that a CDP hearing need not be face-to-face but can take place by telephone or by correspondence.[29] Appeals presumptively establishes telephonic CDP hearings, so it is incumbent on the taxpayer to request a face-to-face conference.[30] The CDP regulations state that taxpayers who provide non-frivolous reasons for opposing the IRS collection action will generally be offered but not guaranteed face-to-face conferences.[31] Taxpayers making frivolous arguments are not entitled to face-to-face conferences.[32] A taxpayer will not be granted a face-to-face conference concerning a collection alternative, such as an IA or OIC, unless other taxpayers would be eligible for the alternative under similar circumstances.[33] For example, the IRS will not grant a face-to-face conference to a taxpayer who proposes an OIC as the only issue to be addressed but has failed to file all required returns and is therefore ineligible for an offer. Appeals may, however, at its discretion, grant a face-to-face conference to explain the eligibility requirements for a collection alternative.[34]

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26 IRC § 6330(e)(1) provides the general rule for suspending collection activity. IRC § 6330(f) provides that if collection of the tax is deemed in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS served a disqualified employment tax levy or a federal contractor levy, IRC § 6330 does not apply, except to provide the opportunity for a CDP hearing within a reasonable time after the levy. See *Clark v. Comm'r*, 125 T.C. 108, 110 (2005) (citing *Dora v. Comm'r*, 119 T.C. 356 (2002)).

27 IRC §§ 6330(e)(1) and (e)(2).

28 IRC § 6320(b)(4).

29 *Katz v. Comm'r*, 115 T.C. 329, 337-38 (2000) (finding that telephone conversations between the taxpayer and the Appeals Officer constituted a hearing as provided in IRC § 6320(b)). Treas. Reg. §§ 301.6320-1(d)(2) A-D6, A-D8 and 301.6330-1(d)(2) A-D6, A-D8.

30 *See, e.g.*, Appeals Letter 4141 (rev. Aug. 2012) acknowledges the taxpayer's request for a CDP hearing and provides information on the availability of a face-to-face conference. The National Taxpayer Advocate has repeatedly raised concerns regarding the inadequacy of Appeals' discussion on how to request a face-to-face hearing and the location of this discussion in the letter. See National Taxpayer Advocate 2005 Annual Report to Congress 136 (Most Serious Problem: *Appeals Campus Centralization*), National Taxpayer Advocate 2009 Annual Report to Congress 70 (Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Customer Satisfaction or Confidence in Appeals*); and National Taxpayer Advocate 2010 Annual Report to Congress 128 (Most Serious Problem: *The IRS's Failure To Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity To Have Their Cases Fully Considered*). In response to taxpayers' and their representatives' dissatisfaction with the Appeals' CDP hearings, including the difficulty of receiving a face-to-face hearing, TAS worked with Appeals to test the use of "telepresence" or "virtual" face-to-face hearings. This test began in 2011 between two Low Income Taxpayer Clinics and two campus Appeals units and is ongoing For a further discussion, see Status Update: *The IRS Has Made Significant Progress in Delivering Virtual Face-To-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance, supra*.

31 Treas. Reg. § 301.6320-1(d)(2) A-D8.

32 Treas. Reg. §§ 301.6320-1(d)(2) A-D7 and 301.6330-1(d)(2) A-D7. Appeals Letter 3846 (rev. July 2008) provides that to be allowed a face-to-face conference about collection alternatives the taxpayer must have filed all required returns.

33 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8.

34 *Id. See also* National Office Program Manager Technical Advice, PMTA-2010-0153 (March 23, 2010). Internal Revenue Manual (IRM) 8.22.5.6.1 (Mar. 29, 2012) addresses how Appeals should handle a request for a face-to-face conference when the taxpayer has not produced the collection information necessary to evaluate the collection alternative. Consistent with the regulations, IRM 8.22.5.6.1(13) states: "Grant a face-to-face request if it is necessary to explain the requirements for becoming eligible for a collection alternative. See Policy Statement P-5-100, which is also IRM 1.2.14.1.17. Examples include a taxpayer with a hearing impairment, who speaks little or no English, or who lacks sophistication. Under these or similar circumstances, grant a face-to-face conference."

The CDP hearing is to be held by an impartial officer from Appeals, who is barred from engaging in *ex parte* communication with IRS employees about the substance of the case and who has had "no prior involvement" in the case.[35] In addition to addressing the issues raised by the taxpayer, the Appeals Officer must verify that the IRS has met the requirements of all applicable laws and administrative procedures.[36] In its determination, Appeals must weigh the issues raised by the taxpayer and decide whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be no more intrusive than necessary.[37]

Special rules apply to the IRS's handling of hearing requests that raise frivolous issues. IRC § 6330(g) provides that the IRS may disregard any portion of a hearing request based on a position the IRS has identified as frivolous, or that reflects a desire to delay or impede the administration of tax laws.[38] Similarly, IRC § 6330(c)(4) provides that a taxpayer cannot raise an issue at a hearing if it is based on a position identified as frivolous or reflects a desire to delay or impede tax administration.

IRC § 6702(b) allows the IRS to impose a penalty for a specified frivolous submission, including a frivolous CDP hearing request.[39] A request is subject to the penalty if any part of it "(i) is based on a position which the Secretary has identified as frivolous...or (ii) reflects a desire to delay or impede the administration of the Federal tax laws."[40] In *Thornberry v. Comm'r*, the Tax Court held that if Appeals determines a request for an administrative hearing is based entirely on a frivolous position under IRC § 6702(c), and issues a notice stating that Appeals will disregard the request, the Tax Court does have jurisdiction to review Appeals' decision if the taxpayer timely petitions for review. The Tax Court found that Appeals' letter disregarding the hearing request was a determination conferring jurisdiction under IRC § 6330(d)(1) because it authorized the IRS to proceed with the disputed collection action.[41]

35 IRC §§ 6320(b)(1), 6320(b)(3), 6330(b)(1) and 6330(b)(3). *See also* Rev. Proc. 2012-18, 2012-1 C.B. 455. See, *e.g.*, *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo 2006-93, *action on dec.*, 2007-2 (Feb. 27, 2007); *Cox v. Comm'r*, 514 F.3d 1119, 1124-1128 (10th Cir. 2008), *action on dec.*, 2009-22 (June 1, 2009).

36 IRC § 6330(c)(1); *Hoyle v. Comm'r*, 131 T.C. 197 (2008).

37 IRC § 6330(c)(3)(C).

38 IRC § 6330(g). Section 6330(g) is effective for submissions made and issues raised after the date on which the IRS first prescribed a list of frivolous positions. Notice 2007-30, 2007-1 C.B. 883, which was published on or about April 2, 2007, provided the first published list of frivolous positions. Notice 2010-33, 2010-17 C.B. 609, contains the current list.

39 The frivolous submission penalty applies to the following submissions: CDP hearing request, OIC, IA, and application for a taxpayer assistance order.

40 IRC § 6702(b)(2)(a). Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous hearing request. The taxpayer then has 30 days to withdraw the submission to avoid the penalty. IRC § 6702(b)(3).

41 *Thornberry v. Comm'r*, 136 T.C. 356 (2011). The Office of Chief Counsel disagrees with the *Thornberry* holding and will continue to file motions to dismiss for lack of jurisdiction if the taxpayer petitions for Tax Court review of a denial, under § 6330(g), of a CDP hearing request that was determined to be based on a frivolous position. See CC-Notice 2012-003 (Dec. 2, 2011).

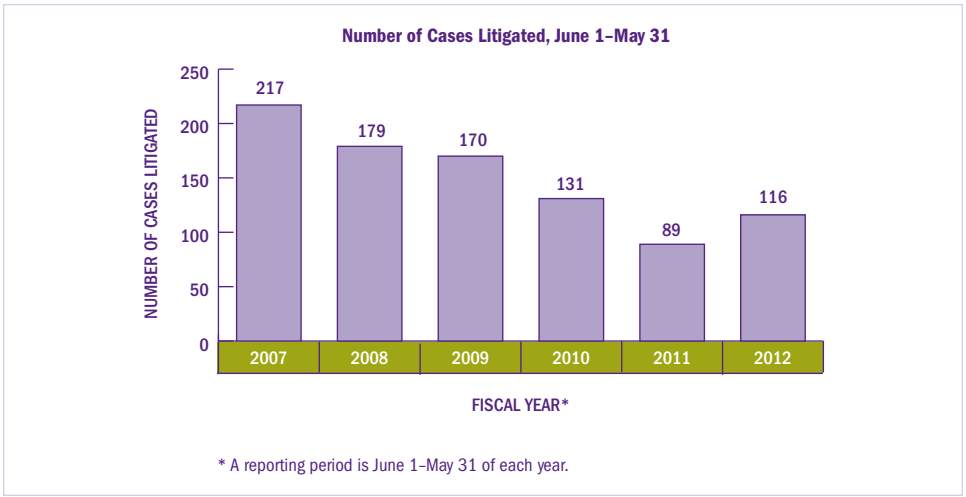
Judicial Review of CDP Determination

Within 30 days of Appeals' determination, the taxpayer may petition the Tax Court for judicial review.[42] Where the validity of the underlying tax liability is properly at issue in the hearing, the court will review the amount of the tax liability on a *de novo* basis.[43] Where the appropriateness of the collection action is at issue, the court will review the IRS's administrative determination for abuse of discretion.[44]

ANALYSIS OF LITIGATED CASES

We identified and reviewed 116 CDP court opinions, a 30 percent increase from the 89 cases in last year's report. As shown in the chart below, litigation of CDP cases had declined considerably over the past several years; however, the number now appears to be ticking back up slightly.

FIGURE 3.3.1, CDP Cases Litigated Between 2007 and 2012[45]



The 116 opinions identified this year do not reflect the full number of CDP cases because the court does not issue an opinion in all cases. Some are resolved through settlements,

42 IRC § 6330(d)(1). Prior to October 17, 2006, the taxpayer could also petition the federal district court if the Tax Court did not have jurisdiction over the underlying tax liability (*e.g.*, if the matter involved an employment tax liability).

43 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. Rep. No. 105-99, at 266 (Conf. Rep.). The term *de novo* means anew. *Black's Law Dictionary*, 447 (7th ed. 1999).

44 See, *e.g.*, *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006).

45 National Taxpayer Advocate 2007 Annual Report to Congress 569 (Most Litigated Issue: *Appeals from Collection Due Process Hearings Under Internal Revenue Code Section 6320 and 6330*), National Taxpayer Advocate 2008 Annual Report to Congress 476 (Most Litigated Issue: *Appeals from Collection Due Process Hearings Under Internal Revenue Code Section 6320 and 6330*), National Taxpayer Advocate 2009 Annual Report to Congress 418 (Most Litigated Issue: *Appeals from Collection Due Process Hearings Under Internal Revenue Code Section 6320 and 6330*), National Taxpayer Advocate 2010 Annual Report to Congress 436 (Most Litigated Issue: *Appeals from Collection Due Process Hearings Under Internal Revenue Code Section 6320 and 6330*), and National Taxpayer Advocate 2011 Annual Report to Congress 619 (Most Litigated Issue: *Appeals from Collection Due Process Hearings Under Internal Revenue Code Section 6320 and 6330*).

and in other cases, taxpayers do not pursue litigation after filing a petition with the court. The Tax Court also disposes of some cases by issuing unpublished orders. Table 3 in Appendix III provides a detailed list of the CDP opinions, including specific information about the issues, the types of taxpayers involved, and the outcomes of the cases.

Litigation Success Rate

Taxpayers prevailed in full in eight of the 116 cases (approximately seven percent).[46] Of the cases in which the courts found for the taxpayer in whole or in part, the taxpayers appeared *pro se* in nine cases[47] and were represented in the six others.[48] This was the IRS's lowest success rate in litigating CDP cases over the past ten years. Table 3.3.2 below compares litigation success rates in CDP cases reported in the 2003 through 2012 Annual Reports to Congress.

TABLE 3.3.2, Success Rates in CDP Cases[49]

Court Decision	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Decided for IRS	96%	95%	89%	90%	92%	90%	92%	89%	92%	86%
Decided for Taxpayer	1%	4%	8%	8%	5%	8%	4%	10%	3%	7%
Split Decision	3%	1%	3%	2%	3%	2%	4%	2%	3%	6%
Neither	N/A	N/A	N/A	N/A	Less than 1%	N/A	N/A	N/A	1%	Less than 1%

ISSUES LITIGATED

The cases discussed below are those the National Taxpayer Advocate considers significant or noteworthy. Their outcomes can provide important information to Congress, the IRS, and taxpayers about the rules and operation of CDP hearings. Equally important, all of the cases offer the opportunity to improve the CDP process, in both application and execution.

46 *Dingman v. Comm'r*, T.C. Memo. 2011-116; *Fatehi v. Comm'r*, T.C. Summ. Op. 2012-26; *Rosenbloom v. Comm'r*, T.C. Memo. 2011-140; *Salahuddin v. Comm'r*, T.C. Memo. 2012-141; *Beeler v. Comm'r*, 434 Fed.Appx. 41 (2nd Cir. 2011), *vacating and remanding* T.C. Memo. 2009-266; *City Wide Transit, Inc. v. Comm'r*, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2nd Cir. Mar. 14, 2012); *Custom Stairs & Trim, Ltd, Inc. v. Comm'r*, T.C. Memo. 2011-155; *Leago v. Comm'r*, T.C. Memo. 2012-39.

47 *Dingman v. Comm'r*, T.C. Memo. 2011-116; *Fatehi v. Comm'r*, T.C. Summ. Op. 2012-26; *Karakaedos v. Comm'r*, T.C. Memo. 2012-53; *Lewis v. Comm'r*, T.C. Memo. 2012-138; *Salahuddin v. Comm'r*, T.C. Memo. 2012-141; *Semen v. Comm'r*, T.C. Memo. 2011-120; *Custom Stairs & Trim, Ltd, Inc. v. Comm'r*, T.C. Memo. 2011-155; *Everett Assocs., Inc. v. Comm'r*, T.C. Memo. 2012-143; *Leago v. Comm'r*, T.C. Memo. 2012-39.

48 *Conway v. Comm'r*, 137 T.C. 209 (2011); *Rosenbloom v. Comm'r*, T.C. Memo. 2011-140; *Beeler v. Comm'r*, 434 Fed.Appx. 41 (2nd Cir. 2011), *vacating and remanding* T.C. Memo. 2009-266; *City Wide Transit, Inc. v. Comm'r*, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2nd Cir. Mar. 14, 2012); *Moreira v. Comm'r*, T.C. Memo. 2011-93; *Pacific West Fin. & Ins. Co. v. Comm'r*, T.C. Memo. 2011-143.

49 Numbers have been rounded to nearest percentage. A "split" decision refers to a case with multiple issues where both the IRS and the taxpayer prevail on one or more substantive issues. A "neither" decision refers to a case where the court's decision was not in favor of either party.

Procedural Rulings

Churchill v. Commissioner

In *Churchill v. Commissioner*,[50] the IRS sent the taxpayer an NFTL and a right to a hearing (a CDP lien notice) for debts associated with tax years 1992 through 2004. Two months later, the IRS sent the taxpayer a final notice of intent to levy and the right to a hearing (a CDP levy notice) for tax years 1998 through 2004. Upon receiving these notices, the taxpayer requested a CDP hearing, asked to discuss the possibility of an OIC, and during these discussions proposed an offer amount. The Appeals Officer informed the taxpayer that the IRS would reject the offer because the Appeals Officer determined that the taxpayer could pay more. Since the taxpayer lived in a community property state, the Appeals Officer included his wife's income, which the taxpayer had omitted, when calculating his collection potential. The Appeals Officer recommended that the taxpayer increase his offer, but the taxpayer did not respond, so the IRS rejected the OIC and sent the taxpayer a notice of determination sustaining the NFTL filing and proposed levy. The taxpayer and his wife divorced before the IRS mailed the notice of determination, but after the CDP hearing.

The Tax Court held that the Settlement Officer did not abuse her discretion in including the community property assets in determining the taxpayer's ability to pay or in upholding the IRS's collection activities. The court also held it has the authority to remand a CDP case for consideration of a material change in the taxpayer's circumstances occurring in the period between the CDP hearing and the Tax Court trial. The court found remand is appropriate whenever it would be "helpful, necessary, or productive." Therefore, the court remanded the case back to Appeals so Appeals could evaluate the taxpayer's OIC in light of the change in the taxpayer's financial circumstances following the divorce (*i.e.,* that his wife's income or assets were no longer available for collection).

Lewis v. Commissioner

In *Lewis v. Commissioner*,[51] the taxpayer voluntarily filed for Chapter 11 bankruptcy. In the bankruptcy proceeding, the IRS filed a proof of claim, and later an amended proof of claim, for tax liabilities for tax years 1999, 2000, 2001, and 2003 and Trust Fund Recovery Penalties (TFRP) for the first and second quarters of 2001. After the bankruptcy proceeding, the examination of tax years 1999, 2000, and 2001 continued. As a result of the examination, the taxpayer signed Form 4549, *Income Tax Examination Changes*, agreeing to partial abatement of tax and additions to tax for 1999 and to additional assessments of tax and additions to tax for tax years 2000 and 2001. The IRS sent the taxpayer a CDP levy notice on April 10, 2008, and the taxpayer asked for a CDP hearing. In the hearing request, the taxpayer stated he was willing to offer collection alternatives, that the amount the IRS sought was inaccurate because it did not reflect amounts paid during bankruptcy, and that the taxpayer was under the protection of his confirmed chapter 11 bankruptcy plan.

50 T.C. Memo. 2011-182.

51 T.C. Memo. 2012-138.

Upon receipt of an IRS letter dated August 21, 2009, identifying the Settlement Officer assigned to his case, the taxpayer called and left a phone message requesting a face-to-face hearing. On September 9, 2009, the Settlement Officer returned the call, and the taxpayer once again expressed his desire for a face-to-face hearing and a collection alternative. The Settlement Officer explained that the taxpayer would need to submit Form 433-A, *Collection Information Statement,* in order for a collection alternative to be considered. The taxpayer agreed to provide the documentation and asked if he could have until September 14, 2009, to send it; the Settlement Officer agreed. The taxpayer claimed the documentation was sent before that date, but the Settlement Officer said it was never received. After the phone call, the taxpayer and Settlement Officer had no further contact until December 21, 2009, when the Settlement Officer issued the notice of determination sustaining the proposed levy. The determination was based solely on the taxpayer's failure to provide the documents necessary to consider a collection alternative.

The Tax Court held that the Settlement Officer abused his discretion because the taxpayer was not afforded a face-to-face CDP hearing as requested, or even a telephone CDP hearing. Nothing indicated that the phone call on September 9, 2009, constituted a CDP hearing. The court further held that the Settlement Officer's determination to sustain the proposed levy, based solely on the grounds that he did not receive documentation, was an abuse of discretion because the Settlement Officer did not attempt to notify the taxpayer that the documentation had not yet been received, and failed to address the issues raised by the taxpayer with respect to the chapter 11 bankruptcy plan.

Weber v. Commissioner

In *Weber v. Commissioner*,[52] the taxpayer appealed an IRS determination to proceed with a levy, arguing that his 2008 income tax had been paid by overpayments for previous years. The taxpayer had filed a return for 2006 claiming an overpayment and electing to have it applied toward his estimated liability for 2007. Shortly thereafter, the IRS made a TFRP assessment against the taxpayer that exceeded the overpayment. Thus, the IRS did not apply the 2006 overpayment to the 2007 estimated tax liability but instead applied it to the TFRP liability.

By August 2008, the TFRP liability had been satisfied from payments by the taxpayer and other responsible persons. The taxpayer proceeded to file his 2007 return, carrying forward the 2006 overpayment per his previous election. The IRS promptly disallowed the carryforward attempt on the 2007 return, but the taxpayer attempted to use the 2006 overpayment credit once again on his 2008 return.

In October 2009, the IRS advised the taxpayer it had adjusted his 2008 estimated tax payments (*i.e.*, reducing them by the claimed 2007 overpayment), that he had a balance due on his 2008 income tax account, and also owed penalties and interest. The taxpayer contended

52 *Weber v. Comm'r*, 138 T.C. No. 18 (2012).

that his overpayments should have been applied in the manner he specified (*i.e.*, 2006 refund applied to 2007 and 2007 refund applied to 2008), satisfying the 2008 liability.

The Tax Court considered whether it had jurisdiction to determine an overpayment with respect to an unrelated liability in a CDP case. For the court to apply overpayments in the manner the taxpayer specified, the court would have to adjudicate his right to an overpayment with respect to the TFRP assessment. The Tax Court held that it did not have jurisdiction over this inquiry because the court lacked jurisdiction to determine the availability of a credit from a non-CDP period that has not been previously determined to be available by a court or the IRS. A taxpayer may only obtain consideration of these claims through the administrative and judicial refund claim process.[53] The Tax Court acknowledged, however, that an overpayment of a TFRP (or any liability) that has been determined by the IRS or a court, but has not yet been refunded or applied to another liability, may be considered in a CDP hearing when determining if the liability remains unpaid.

Leago v. Commissioner

In *Leago v. Commissioner*,[54] a taxpayer who had owned a video rental store failed to file Form 941, *Employer's Quarterly Federal Tax Return*, for all four quarters of 1995 and the fourth quarter of 1996 and Form 940, *Federal Unemployment Tax Return*, for tax year 1996. As a result, the IRS sent a CDP levy notice and, upon receipt of this notice, the taxpayer requested a hearing. During the hearing, the taxpayer requested to be placed in currently not collectible (CNC) status, because he had a brain tumor and was experiencing economic hardship because of his medical problems. At the conclusion of the hearing, the Settlement Officer requested that petitioner submit various information, including a current doctor's statement and Form 433-A, C*ollection Information Statement for Wage Earners and Self-Employed Individuals*. In response, the taxpayer provided letters from doctors regarding his condition and the Form 433-A. Despite these circumstances, the Settlement Officer sustained the proposed levy on the basis that the taxpayer had failed to file federal income tax returns and make tax payments for recent tax years. The taxpayer challenged this determination in Tax Court, which remanded the case for further consideration of whether the taxpayer qualified for any collection alternative. On remand, the taxpayer submitted an OIC, but the Settlement Officer rejected it on the grounds that it failed to adequately reflect the taxpayer's reasonable collection potential (RCP). A significant point of disagreement was what allowance, if any, should have been made for taxpayer's brain surgery.

Generally, for an OIC based on doubt as to collectibility to be accepted, the offer amount must equal or exceed the taxpayer's RCP. Where the taxpayer would, however, suffer economic hardship if the IRS collected an amount equal to the RCP, the IRS may accept a lesser amount if special factors are present.[55] In this context, factors indicating economic

53 In *Weber*, the taxpayer had, in fact, availed himself of the judicial remedy and had filed a refund suit in the District Court with respect to the TFRP.

54 T.C. Memo. 2012-39.

55 Rev. Proc. 2003-71,§ 4.02(3), 2003 C.B 517.

hardship include a long-term illness, medical condition, or disability that renders a taxpayer incapable of earning a living, where it is "reasonably foreseeable that taxpayer's financial resources will be exhausted providing for care and support during the course of the condition."[56]

The Court determined that the Settlement Officer did not appear to have considered the special circumstances related to the economic hardship that were not in dispute (*e.g.,* diagnosis of a brain tumor, need for surgery, the taxpayer's lack of health insurance or significant assets, and continuous health problems that had limited his ability to earn income) when deciding to reject the offer. Therefore, the court remanded the case, ordering Appeals to fully consider the taxpayer's special circumstances when making a final determination of whether to accept the proposed OIC.[57]

Custom Stairs & Trim v. Commissioner

In *Custom Stairs & Trim v. Commissioner*,[58] a small construction business had a long history of timely filing its employment tax returns and making timely tax deposits. In early 2005, however, because of Hurricane Ivan, the taxpayer fell behind in its employment tax obligations and continued to have trouble making these payments until 2009. For most of these tax quarters, the taxpayer actually paid the IRS more than enough to fully satisfy its current tax obligations, but the IRS applied the payments to prior arrearages, which are generally paid first unless the taxpayer specifies otherwise, so the later tax periods had an outstanding balance due.[59] Because of the way the IRS applied the payments, the taxpayer owed employment taxes and associated failure to deposit and failure to pay penalties for the second quarter of 2008.

In late 2008, the IRS sent the taxpayer a CDP lien notice and a CDP levy notice with respect to the employment tax liability for the second quarter of 2008. The taxpayer requested a CDP hearing seeking the abatement of the penalties. The Settlement Officer declined, advising the taxpayer it had not shown reasonable cause for the failure to pay. The Settlement Officer then issued a notice of determination sustaining the NFTL filing and the Notice of Intent to Levy, and the taxpayer appealed the determination to the Tax Court.

After reviewing the Settlement Officer's conclusion that reasonable cause was not present, the court found the taxpayer's failure to make deposits as penalties were accumulating "was due in significant part to Hurricane Ivan, the 2008 economic collapse, and practical fact of the cascading penalties themselves. Quarter after quarter, funds were used to pay then-assessed penalties for the prior quarter at the cost of not making all timely deposits for the

56 Treas. Reg. § 301.7122-1(c)(3)(A).

57 In the Court's decision entered on September. 2, 2012, the parties stipulated that collection of taxpayer's outstanding liabilities would be settled in the amount of $4,000 pursuant to an amended OIC.

58 T.C. Memo. 2011-155.

59 See *Davis v. United States*, 961 F.2d 867 (9th Cir. 1992), *Concert Staging Services, Inc., v. Comm'r*, T.C. Memo. 1011-231, and Rev. Proc. 2002-26, 2002-15 I.R.B. 746 (Apr. 15, 2002).

current quarter."[60] The court found reasonable cause was present in these circumstances and that the penalties should be abated. Further, the court found the taxpayer had acted with business care by taking significant steps to reduce expenses in an effort to keep up with its tax obligations and keep the business alive (*e.g.,* laying off employees, eliminating vacations and paid holidays, and curtailing benefits). The court noted that a memorandum in the administrative file, written by the Taxpayer Advocate Service, provided elaborate details of the good faith efforts the taxpayer had made to resolve its tax problem. The court, in rejecting the IRS's argument that Custom Stairs should go out of business if it could not afford to make its tax payment timely, emphasized that this approach hurts the country's economy and the federal fisc.

Conway v. Commissioner

In *Conway v. Commissioner*,[61] the IRS assessed TFRPs under IRC § 6672 against Michael Conway (Conway) and Raymond Nakano (Nakano), the chief executive officer (CEO) and chief financial officer (CFO), respectively, of National Airlines, Inc. (National), for National's failure to pay excise taxes.[62] The IRS then issued a CDP lien notice to Conway and a CDP levy notice to Nakano in an attempt to collect the TFRP assessments. Both taxpayers requested a CDP hearing in response to the notices, and at the taxpayers' requests, they received a joint hearing. In their hearing requests, the taxpayers claimed the IRS had failed to issue notice and demand for payment within 60 days of the assessment, thereby precluding the IRS from collecting the TFRP assessments by lien or levy.[63] Appeals sustained the filing of the NFTL and proposed levy action, and both Conway and Nakano filed Tax Court petitions challenging the Appeals determinations. The two cases were consolidated by the Tax Court.

Nakano claimed the IRS did not give him notice and demand within 60 days of any assessment or properly assess the TFRPs against him, thereby making the proposed levy an abuse of discretion. However, the Tax Court determined the CDP levy notice also served as a notice and demand for payment, because it went beyond the usual proposed levy notice and specifically identified the type and amount of unpaid tax for each tax period, explicitly demanded payment, and was sent within 60 days of the assessments, thereby meeting the applicable statutory requirements. Nakano also argued the TFRP assessments were invalid as untimely. However, the Court found no evidence suggesting the IRS did not timely assess the TFRPs.

60 T.C. Memo. 2011-115.

61 137 T.C. 209 (2011).

62 National operated from 1999 to 2001. When it ceased operating, it had reported but unpaid transportation excise taxes. IRC § 9502 establishes the Airport and Airway Trust Fund, which includes, in part, excise taxes collected by airlines under IRC § 4261. Because the airline failed to pay over the trust fund taxes, the IRS may pursue collection by making assessments under IRC § 6672.

63 In their hearing request, the taxpayers had also argued they were not liable for the TFRP assessments. However, during the hearing, they conceded that they could not contest the underlying liability as part of the CDP process. Both Conway and Nakano filed refund suits to contest the assessments, and both were found liable for the assessments. See *Conway v. United States*, 103 A.F.T.R.2d 2009-2523 (E.D. Tex. 2009); *Nakano v. United States*, 104 A.F.T.R.2d 2009-5421 (D. Ariz. 2009).

Conway also argued the IRS failed to provide him notice and demand within 60 days of the assessment. The IRS argued that Letter 3164B, the CDP lien Notice and Form 3552, *Notice of Tax Due* (hereafter referred to as Notice of Tax Due) all constituted notice and demand. Alternatively, the IRS argued that it did not need to issue notice and demand to Conway because he was already aware of the unpaid tax and demand for payment as a result of his role as National's CEO.

The Tax Court determined the Letter 3164B did not constitute valid notice and demand for payment under IRC § 6303 because it did not state the amounts, types, or periods of the unpaid taxes. Moreover, it was also defective because the letter was not sent after the assessment was made nor was it sent to the taxpayer's "dwelling or usual place of business" or mailed to his last known address as required by § 6303.

Next, the court considered whether the CDP lien notice could serve as both a notice and demand under § 6303 and a CDP lien notice under § 6320. The court found that the IRS can only issue a CDP lien notice after notice and demand have been made and the taxpayer refuses to pay. Thus, a CDP lien notice cannot serve as both notice and demand for payment and a CDP lien notice. Last, the court found that the Notice of Tax Due did not constitute notice and demand because it was sent after the NFTL was filed.

Finally, the court held that any notice Conway may have had as a result of his role as CEO did not eliminate the need for the IRS to issue notice and demand for payment prior to filing the NFTL.

For these reasons, the court found the IRS had failed to give notice and demand for payment before filing the NFTL. Thus, the NFTL filing was premature and should have been withdrawn under IRC § 6323(j)(1)(A), and Appeals' determination to sustain the NFTL filing against Conway was an abuse of discretion.

Gillum v. Commissioner

In *Gillum v. Commissioner*,[64] the taxpayer appealed the Tax Court's decision to uphold the filing of the NFTL and the proposed levy, arguing that he was not afforded a fair CDP hearing. The taxpayer alleged that the Settlement Officer relied on information that was not part of the administrative record when the proposed OIC was evaluated. According to the taxpayer, the Settlement Officer admitted during the Tax Court trial to providing an incomplete administrative record to the Tax Court.

The Appeals Court upheld the Tax Court's decision that the taxpayer was afforded a fair CDP hearing. First, the Appeals Court determined that the Settlement Officer never admitted during the Tax Court trial to providing an incomplete administrative record as the taxpayer suggested. In fact, the trial transcript revealed that the Settlement Officer confirmed

64 676 F.3d 633 (8th Cir. 2012), *aff'g* T.C. Memo. 2010-280.

that the administrative record was complete and the facts relied upon in making a determination were a part of the administrative record. Second, the court found that even if the Settlement Officer did rely on documents outside of the administrative record, the error was harmless. The Appeals Court agreed with the Tax Court that the Settlement Officer did not improperly rely on information outside the record when making the determination to reject the proposed OIC; it therefore, affirmed the decision.

Imposition of Sanctions

IRC § 6673(a)(1) authorizes the Tax Court to impose sanctions when it appears that proceedings have been instituted or maintained primarily for delay or when the taxpayer's position is frivolous or groundless.[65] These penalties are meant to deter the filing of frivolous CDP hearing requests. As we found in last year's analysis, the court imposed these penalties in only a few CDP cases. Of the 116 CDP cases reviewed this year, the court imposed sanctions in only eight, or approximately seven percent.[66] Last year, with 89 CDP cases decided, the court imposed sanctions in four cases, or four percent.[67] This low number may be attributable to IRC § 6330(g), which allows the IRS to disregard a frivolous hearing request.

Pro Se Analysis

Pro se taxpayers (those without benefit of counsel) litigated 81 (or 70 percent) of the 116 CDP cases brought before the Tax Court, an increase from 63 percent in the previous year. Table 3.3.3 shows the breakdown of *pro se* and represented cases and the decisions rendered by the court, indicating that 15 taxpayers, represented or unrepresented (or about 13 percent of the 116 cases), received some relief on judicial review.

TABLE 3.3.3, *Pro Se* and Represented Taxpayer Cases and Decisions

Court Decisions	*Pro Se* Taxpayers		Represented Taxpayers	
	Volume	Percentage of Total	Volume	Percentage of Total
Decided for IRS	71	88%	29	83%
Decided for Taxpayer	5	6%	3	9%
Split Decisions	4	5%	3	9%
Neither[68]	1	1%		
Totals:[69]	**81**		**35**	

65 For a more detailed discussion of IRC § 6673, see Most Litigated Issue: *Frivolous Issues Penalty Under IRC § 6673 and Related Appellate Level Sanctions, infra*.

66 See, *Alexander v. Comm'r*, T.C. Memo. 2012-75; *Byrd v. Comm'r*, T.C. Memo. 2011-146; *Jackson v. Comm'r*, T.C. Memo. 2012-58; *Lee v. Comm'r*, 463 Fed. Appx. 236 (5th Cir. 2012); *McNeil v. Comm'r*, T.C. Memo. 2011-150, *aff'd*, 451 Fed.Appx. 622 (8th Cir. 2012); *Tinnerman v. Comm'r*, 448 Fed.Appx. 73 (D.C. Cir. 2012), *aff'g* T.C. Memo. 2010-150; *Umoren v. Comm'r*, T.C. Memo. 2012-117; *Weybrew v. Comm'r*, 451 Fed.Appx. 257 (4th Cir. 2011).

67 National Taxpayer Advocate 2011 Annual Report to Congress 629.

68 *Campbell v. Comm'r*, T.C. Memo. 2012-82.

69 Due to rounding, the percents may not add up to exactly 100 percent.

CONCLUSION

CDP hearings continue to provide an invaluable opportunity for taxpayers to meaningfully address the appropriateness of IRS collection actions. Given the important protection that CDP hearings offer, it should be of little surprise that CDP remains one of the most frequently litigated tax issues in the federal courts — a trend unlikely to change anytime soon. In fact, the number of CDP cases litigated increased this year by about 30 percent when compared to last year. Further, this year the IRS had the lowest success rate for litigating CDP cases when compared to all years since 2003. The cases this year illustrate the discretion of the Settlement Officer to consider special circumstances surrounding cases and impacting taxpayers, such as health conditions and the impact of natural disasters and economic conditions on businesses. The IRS should review the cases in which the taxpayer prevailed, particularly those involving special circumstances, so it can improve its processes and not unnecessarily burden taxpayers who are experiencing such difficulties.

The Tax Court also grappled with whether it had jurisdiction to determine an overpayment of an unrelated liability in a CDP case. Finally, the Eighth Circuit Court of Appeals considered whether a Settlement Officer reviewed information outside the administrative record when making a final determination, and if so, whether it was harmful to the fairness of the hearing. Because of the important role of CDP hearings in protecting taxpayer rights, taxpayers and their representatives will likely continue to pursue their CDP rights in court, and CDP will most likely continue to be a heavily litigated issue in years to come.

MLI #4

Trade or Business Expenses Under IRC § 162 and Related Sections

SUMMARY

The deductibility of trade or business expenses is perennially among the ten Most Litigated Issues. We identified 115 cases involving a trade or business expense issue that were litigated between June 1, 2011, and May 31, 2012. The courts affirmed the IRS position in the majority (approximately 69 percent) of cases, while taxpayers prevailed about five percent of the time.[1] The remaining cases resulted in split decisions.

PRESENT LAW

Internal Revenue Code (IRC or the "Code") § 162 allows deductions for ordinary and necessary trade or business expenses paid or incurred during the course of a taxable year. Rules regarding the practical application of IRC § 162 have evolved largely from case law and administrative guidance. The IRS, the Department of the Treasury, Congress, and the courts continue to provide guidance about whether a taxpayer is entitled to claim certain deductions. The cases analyzed for this report illustrate that this process is ongoing and involves the analysis of facts and circumstances. When a taxpayer seeks judicial review of the IRS's determination of a tax liability stemming from the deductibility of a particular expense, the courts must often address a series of questions, including those discussed below.

What is a trade or business expense under § 162?

Although "trade or business" is one of the most widely used terms in the IRC, neither the Code nor the Treasury Regulations provide a definition.[2] The definition of a "trade or business" comes from common law, where the concepts have been developed and refined by the courts.[3] The Supreme Court has interpreted "trade or business" for purposes of IRC § 162 to mean an activity conducted with "continuity and regularity" and with the primary purpose of earning income or making profit.[4]

What is an ordinary and necessary expense?

IRC § 162(a) requires a trade or business expense to be both "ordinary" and "necessary" in relation to the taxpayer's trade or business in order to be deductible. In *Welch v. Helvering*, the Supreme Court stated that the words "ordinary" and "necessary" have different meanings, both of which must be satisfied for a taxpayer to benefit from the deduction.[5] The Supreme Court describes an "ordinary" expense as customary or usual and of common or

1 The IRS prevailed in full in 79 out of the 115 cases, while taxpayers prevailed in full in only six cases.

2 In 1986, the term "trade or business" appeared in at least 492 subsections of the Code and in over 664 Treasury Regulations. *See* F. Ladson Boyle, *What is a Trade or Business?* 39 Tax Law. 737 (Summer 1986).

3 Carol Duane Olson, *Toward a Neutral Definition of "Trade or Business" in the Internal Revenue Code*, 54 U. Cin. L. Rev. 1199 (1986).

4 *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

5 290 U.S. 111, 113 (1933).

frequent occurrence in the taxpayer's trade or business.[6] The Court describes a "necessary" expense as one that is appropriate and helpful for development of the business.[7]

Common law also requires that in addition to being ordinary and necessary, the amount of the expense must be reasonable for the expense to be deductible. In *Commissioner v. Lincoln Electric Co.*, the Court of Appeals for the Sixth Circuit held "the element of reasonableness is inherent in the phrase 'ordinary and necessary.' Clearly it was not the intention of Congress to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount."[8]

Is the expense a currently deductible expense or a capital expenditure?

A currently deductible expense is an ordinary and necessary expense that is paid or incurred during the taxable year in the course of carrying on a trade or business.[9] No deductions are allowed for the cost of acquisition, construction, improvement, or restoration of an asset expected to last more than one year.[10] Instead, capital expenditures may be subject to amortization, depletion, or depreciation over the useful life of the property.[11]

Whether an expenditure is deductible under IRC § 162(a) or is a capital expenditure under IRC § 263 is a question of fact. Courts have adopted a case-by-case approach to applying principles of capitalization and deductibility.[12]

When is an expense paid or incurred during the taxable year, and what proof is there that the expense was paid?

IRC § 162(a) requires an expense to be "paid or incurred during the taxable year" to be deductible. The Code also requires a taxpayer to maintain books and records that substantiate income, deductions, and credits—including adequate records to substantiate deductions claimed as trade or business expenses.[13] If a taxpayer cannot substantiate exact amounts of deductions by documentary evidence (*e.g.*, invoice, paid bill, or canceled check), but can establish that he or she had some business expenditures, the courts may employ the *Cohan* rule to grant the taxpayer a reasonable amount of deductions.

The *Cohan* rule is one of "indulgence" established in 1930 by the Court of Appeals for the Second Circuit in *Cohan v. Commissioner*.[14] The court held that the taxpayer's business expense deductions were not adequately substantiated, but stated that "the [Tax Court]

6 *Deputy v. du Pont*, 308 U.S. 488, 495 (1940) (citation omitted).

7 *Comm'r v. Tellier*, 383 U.S. 687, 689 (1966) (citations omitted).

8 176 F.2d 815, 817 (6th Cir. 1949), *cert. denied*, 338 U.S. 949 (1950).

9 IRC § 162(a).

10 IRC § 263. *See also INDOPCO, Inc. v. Comm'r*, 503 U.S. 79 (1992).

11 IRC § 167.

12 See PNC Bancorp, Inc. v. Comm'r, 212 F.3d 822 (3d Cir. 2000); *Norwest Corp. v. Comm'r*, 108 T.C. 265 (1997).

13 IRC § 6001. *See also* Treas. Reg. §§ 1.6001-1 and 1.446-1(a)(4).

14 39 F.2d 540 (2d Cir. 1930).

should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent."[15]

The *Cohan* rule may not be used in situations where IRC § 274(d) applies. Section 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deductions are allowable for:

1. Travel expenses;
2. Entertainment, amusement, or recreation expenses;
3. Gifts; or
4. Certain "listed property."[16]

A taxpayer must substantiate a claimed IRC § 274(d) expense with adequate records or sufficient evidence to establish the amount, time, place, and business purpose.[17]

Who has the burden of proof in a substantiation case?

Generally, the taxpayer bears the burden of proving that he or she is entitled to the business expense deductions and the IRS's proposed determination of tax liability is incorrect.[18] IRC § 7491(a) provides that the burden of proof shifts to the IRS when a taxpayer:

- Introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer's liability;
- Complies with the requirements to substantiate deductions;
- Maintains all records required under the Code; and
- Cooperates with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews.[19]

ANALYSIS OF LITIGATED CASES

Trade or business expenses have been one of the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998.[20] This year, we reviewed 115 cases involving trade or business expense issues that were litigated in federal courts from June 1, 2011, through May 31, 2012. Table 4 in Appendix III

15 *Id.* at 544 (2d Cir. 1930), *aff'g and remanding* 11 B.T.A. 743 (1928).

16 "Listed property" means any passenger automobile; any property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; any computer or peripheral equipment (except when used exclusively at a regular business establishment and owned or leased by the person operating such establishment); and any other property specified by regulations. IRC § 280F(d)(4)(A) and (B).

17 Treas. Reg. § 1.274-5T(b).

18 *See Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted) and U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

19 IRC § 7491(a)(1) applies to a court proceeding in which the examination started after July 22, 1998, and if there is no examination, to the taxable period or events which started or occurred after July 22, 1998.

20 *See* National Taxpayer Advocate 1998-2011 Annual Reports to Congress.

contains a list of the main issues in those cases. Table 3.4.1 (below) categorizes the main issues raised by taxpayers. Cases involving more than one issue are included in more than one category.

TABLE 3.4.1, Trade or Business Expense Issues in Cases Reviewed

Issue	Type of Taxpayer	
	Individual	Business (including sole proprietorships)
Substantiation of expenses, including application of the *Cohan* rule[21]	13	59
Profit objective[22]	2	10
Ordinary and necessary trade or business expenses[23]	6	8
Personal vs. business expenses[24]	6	11
Business expenses vs. capital expenditures[25]	0	3
Education expenses[26]	2	1
Did the taxpayer establish the carrying on of a trade or business?	3	12
Gambling expenses[27]	0	1

Approximately 62 percent of the taxpayers litigating trade or business deduction issues represented themselves (*pro se*). Taxpayers represented by counsel actually fared slightly worse than their *pro se* counterparts. Taxpayers with representation received full or partial relief in approximately 30 percent of litigated cases (13 of 44), while *pro se* taxpayers received full or partial relief in about 32 percent of litigated cases (23 of 71).

21 IRC § 6001 and Treas. Reg. § 1.6001-1 require a taxpayer to maintain books and records that substantiate income, deductions and credits. Treas. Reg. § 1.162-17 provides guidance regarding maintaining adequate records to substantiate deductions claimed as trade or business expenses in connection with the performance of services as an employee. The Cohan rule allows courts to estimate certain expenses not properly substantiated. *See Cohan v. Comm'r,* 39 F.2d 540, 544 (2d Cir. 1930).

22 IRC § 183(a) provides the general rule that no deduction attributable to an activity engaged in by an individual or an S corporation shall be allowed if such activity is not engaged in for profit. Treas. Reg. § 1.183-2(b) provides the following nonexhaustive list of nine factors to consider in determining whether an activity is conducted for profit: (1) manner in which the taxpayer carries on the activity; (2) expertise of the taxpayer or his advisors; (3) time and effort expended by the taxpayer in carrying on the activity; (4) expectation that assets used in the activity may appreciate in value; (5) success of the taxpayer in carrying on similar or dissimilar activities; (6) taxpayer's history of income or losses with respect to the activity; (7) amount of occasional profits, if any, which are earned; (8) financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

23 IRC § 162(a) allows deductions for ordinary and necessary trade or business expenses paid or incurred during the taxable year.

24 IRC § 262(a) provides that personal, living, and family expenses are generally not deductible.

25 Under IRC § 263(a), generally no deduction is allowed for capital expenditures, where capital expenditures include any amount paid for permanent improvements made to increase the value of any property. Under IRC § 195(a), start-up expenditures generally cannot be deducted unless a taxpayer makes an expense/amortization election according to IRC § 195(b). Taxpayers who make the election may generally deduct up to $5,000 of start-up expenditures in the tax year in which an active trade or business begins and amortize any excess over 180 months. The $5,000 deduction is reduced by a dollar for every dollar that total start-up expenditures exceed $50,000. See IRC § 195(b)(1)(A), (B). (These amounts are increased to $10,000 and $60,000 for taxable years beginning in 2010. See IRC § 195(b)(3).)

26 Treas. Reg. § 1.162-5(a) provides that a taxpayer may deduct educational expenses under IRC § 162(a) if the education maintains or improves skills required by the individual in his or her employment or other trade or business, or meets the express requirements of the individual's employer.

27 IRC § 165(d) provides that "[l]osses from wagering transactions shall be allowed only to the extent of the gains from such transactions."

Individual Taxpayers

Not one of the 19 decisions involving individual taxpayers (where the term "individual" excludes a sole proprietorship) was issued as a regular opinion of the Tax Court.[28] Of the 19 cases litigated by individual taxpayers, all but three appeared *pro se*. One individual taxpayer received full relief, and five of the individual cases resulted in split decisions.

The most prevalent issue was the substantiation of claimed trade or business expense deductions, which appeared in 13 cases. For example, in *Lyseng v. Commissioner*,[29] the Tax Court denied several deductions for lack of substantiation, including depreciation on a travel trailer, laundry services, vehicle permit costs, and towing expenses. The taxpayer provided no evidence to substantiate the laundry, vehicle, and towing expenses, and therefore the court disallowed the deductions. In regard to the depreciation deduction, the taxpayer provided no evidence substantiating the trailer's cost basis — no bill of sale, canceled check, or third-party corroborating testimony. The Tax Court did find that the taxpayer substantiated the deductions for unreimbursed automobile expenses and some union dues. The taxpayer kept a mileage record with the dates of travel and provided credible testimony regarding the business purpose of each trip he took for his employer. A pay stub from an employer, combined with credible taxpayer testimony, also convinced the court to partially allow some of the union dues.

Even when the individual taxpayer maintains records to substantiate a deduction, he or she still has to prove the expense is ordinary and necessary to a trade or business. In *Farias v. Commissioner*,[30] the taxpayer was a teacher who claimed deductions for unreimbursed employee expenses for the purchase of a specialty chair, an adjustable headrest, a pillow, and ice/heat pads. The taxpayer claimed she purchased the items because she suffered a back injury when she moved her classroom. The taxpayer also taught fitness classes and claimed deductions for fitness items, including clothing. The Tax Court upheld the IRS's denial of the deductions because the purchases were not ordinary and necessary to her teaching position. The Tax Court also disallowed the taxpayer's deductions for fitness expenses because she failed to clearly describe the items purchased and to prove the clothing was ordinary and necessary in her trade or business. The court further determined the clothing deduction was not allowable because the clothing was suitable for general use.

Another case involving an individual taxpayer required an analysis of whether typical living and leisure activities could be viewed as "business" activities conducted in pursuit of a profit under IRC § 183(a). The taxpayer in *Faust v. Commissioner*, a retired minister, created

28 Tax Court decisions fall into three categories: regular decisions, memorandum decisions, and small tax case ("S") decisions. The regular decisions of the Tax Court include cases which have some new or novel point of law, or in which there may not be general agreement, and therefore have the most legal significance. In contrast, memorandum decisions generally involve fact patterns within previously settled legal principles and therefore are not as significant. Finally, "S" case decisions (for disputes involving $50,000 or less) are not appealable and, thus, have no precedential value. *See* IRC § 7463(b). *See also* U.S. Tax Court Rules of Practice and Procedure, Rules 170-175. All but seven of the cases involving individual taxpayers (excluding sole proprietorships) were "S" cases.

29 T.C. Memo. 2011-226.

30 T.C. Memo. 2011-248.

an enterprise called "MacLeisure Creations," which essentially encompassed all of his daily activities.[31] He claimed income from the enterprise on his Forms 1040, for both 2005 and 2006. The taxpayer also took business deductions for those years for, among other expenses, books, comedy shows, boating equipment, washing machine repairs, utility and phone bills, and dinner outings with his spouse. In upholding the IRS's disallowance of the deductions, the court ultimately determined the enterprise was not conducted for profit under the nine factors of Treasury Regulation § 1.183-2(b).[32] The Tax Court decided the activities were not for profit primarily because the taxpayer had never earned a profit,[33] relied on other income to subsidize his activities, showed no expertise, did not seek business advice, kept no separate bank accounts or books, and experienced much personal pleasure in pursuing the activities under the guise of his enterprise.

Business Taxpayers

Ninety-six cases involved business taxpayers, who had similar success to individual taxpayers in obtaining a favorable outcome. Business and individual taxpayers received full or partial relief in about 31 percent of cases (30 of 96 and six of 19, respectively). Business taxpayers were represented by counsel in 11 of the favorably decided cases.

As with individual taxpayers, substantiation of expenses was by far the most prevalent issue,[34] and in some instances the court denied business taxpayers' deductions for failure to substantiate.[35] Courts were willing to uphold a taxpayer's deductions when there was enough evidence for proper substantiation.[36] Courts occasionally applied the *Cohan* rule where the taxpayer presented sufficient documentation to prove an expense was incurred, but had limited documentation of the precise amount.[37]

Another common difficulty was failure to prove that expenses were ordinary and necessary to the taxpayer's business. In *Fuhrman v. Commissioner*, the taxpayer husband owned a trucking business consisting of five wholly-owned corporations and an LLC that owned 30 trucks.[38] The LLC leased its trucks solely to related businesses, but principally to one of the wholly-owned corporations. The same wholly-owned corporation provided safety, sales

31 T.C. Memo. 2011-158.

32 *See* footnote 22, *supra*, for the nine factors. The IRS allowed the taxpayer itemized deductions for expenses up to the amount of gross income reported from the activities under IRC § 183(b)(2), consisting of $235 for 2005 and $210 for 2006. The court stated that this limitation was proper because the enterprise was not conducted for profit. However, the court did not reach the issue of substantiation of expenses, or specify which activities generated the gross income. T.C. Memo. 2011-158.

33 MacLeisure Creations had large net losses for eight consecutive years. T.C. Memo. 2011-158.

34 Substantiation of expenses was at issue in 56 out of 97 cases (58 percent) involving business taxpayers.

35 *See, e.g., Colvin v. Comm'r*, T.C. Memo. 2012-26 (deductions denied for failure to substantiate when taxpayer records were destroyed by a flood and oral testimony was too general).

36 *Mali v. Comm'r*, T.C. Memo. 2011-121 (deductions allowed for various substantiated graphic design production expenses, but others denied for failure to show business purpose of payments, failure to substantiate, or inability to prove that the amount of the deduction was not already allowed).

37 *West v. Comm'r*, T.C. Memo. 2011-272 (deductions allowed under *Cohan* for taxpayer's average bricklaying and farming expenses even though exact amounts unknown).

38 T.C. Memo. 2011-236.

management, and driver relations services to the LLC for the taxable years under review, and the latter deducted the costs of these expenses. In upholding the IRS's denial of the deductions, the Tax Court noted that the LLC had no employees or owners other than the taxpayer and had no customers other than the corporation and related entities. The court also noted that the services the corporation provided to the LLC were the type of services that the former normally performed for itself and its customers. The court concluded the taxpayer failed to show how the expenses were necessary for the LLC's leasing activities, and also failed to show that the expenses were ordinary.

Another common question for business taxpayers was whether claimed deductions were attributable to an active trade or business. In *Broz v. Commissioner*,[39] the taxpayer organized an S corporation ("First S Corporation") to conduct a cellular phone business and decided to expand it into new license areas. The taxpayer then formed another S corporation ("Lessee") that would bid on Federal Communications Commission (FCC) licenses, transfer them to its newly-formed subsidiaries, lease them back, and then build and run new digital networks to use the licenses. These subsidiaries ("Lessors") were organized as single-member LLC license-holding companies. They claimed amortization deductions for the licenses under IRC § 197. The Tax Court noted that the question of whether a cell phone business begins upon the grant of FCC licenses or when contracts for wireless service are sold was a question of first impression. The court scrutinized each entity separately to determine whether it conducted an active trade or business, and ultimately denied the Lessors the deductions because neither the Lessors nor the Lessee were actively engaged in a trade or business. The evidence indicated that the First S Corporation, not the Lessee, ran the on-air networks and used the licenses while assigning the income from such activities to the Lessee or Lessors. The court reasoned that the mere transfer of the cellular licenses to the Lessors was not enough to establish an active trade or business under § 162, and the Lessors were thus not entitled to claim the amortization deductions under IRC § 197.

Courts often upheld the IRS's determination that business expense deductions were not attributable to a "for profit" activity that constituted an actual trade or business under § 183. The taxpayer in *Zenzen v. Commissioner* began drag racing as a hobby in his spare time, but eventually bought his own transporter and cars, started a racing team with his children, and deducted various racing costs as business expenses on his Schedule C.[40] The taxpayer did not create a business plan or keep dedicated ledgers or books for racing but did keep receipts and spent a significant amount of time on the activities. The Tax Court referenced the nine factors of Treas. Reg. § 1.183-2(b) in its analysis, and concluded the drag racing was not "for profit." Among the dispositive factors were the facts that the taxpayer spent over 54 times what he made racing, was well-off financially with a full-time job, had no good faith belief that he would make a profit, and gained a great deal of personal pleasure from running the team with his children.

39 137 T.C. 46 (2011), *appeal docketed*, No. 12-1403 (6th Cir. Apr. 6, 2012).

40 T.C. Memo. 2011-167.

Among the other business cases of interest is *Lua* v. *Commissioner*,[41] where the taxpayer (a sole proprietor) proved that cash received by his satellite installers from end-consumers for "additional services" provided during an installation is deductible compensation even though the money never came directly to the taxpayer's business. *F.W. Services, Inc. & Subsidiaries v. Commissioner* involved deductions for amounts paid under insurance policies.[42] The taxpayer, a temporary service agency, obtained two insurance policies from one company to cover worker's compensation and employer liability. Both policies contained a $500,000 loss reimbursement endorsement, so the taxpayer obtained a third policy with a second insurance company establishing a reserve fund to cover the potential reimbursements. The taxpayer deducted the amounts paid under the first insurer's policies as well as those paid to the second insurer, including amounts remaining in the reserve fund, as insurance premiums. The IRS denied the deduction for the amount remaining in the reserve fund, but the taxpayer argued that if the three contracts were viewed as one policy, that amount should be treated as an insurance premium. The Fifth Circuit affirmed the Tax Court, concluding that the amount remaining in the reserve fund was not a premium under § 162(a)[43] even if the three contracts were read together. The court upheld the IRS's denial of the insurance deduction for amounts remaining in the reserve fund because the substance of the transactions indicated that the second insurer's contract created a deposit account and did not shift risk.

CONCLUSION

Taxpayers continue to challenge the IRS's denials of trade or business deductions. From June 1, 2011, through May 31, 2012, those who were represented did not fare better than those who represented themselves — in fact, *pro se* taxpayers fared slightly better, prevailing 32 percent of the time compared to 30 percent for represented taxpayers. Though the IRS generally prevailed, the courts did not always favor the IRS's application of the law to the taxpayers' facts and circumstances. Thus, the definition of an allowable business expense remains open to interpretation and is highly fact-specific.

Many of the cases involving individual taxpayers demonstrate persistent taxpayer confusion over the Code's requirements, especially those in IRC § 274(d) relating to strict substantiation of listed items. The IRS can minimize litigation by providing clear guidance on the deductibility of trade or business expenses. Through education, outreach, and collaboration with stakeholders, the IRS can help taxpayers understand what trade or business deductions are allowable and how to substantiate them.

In several cases involving business taxpayers, the courts sided with the IRS in denying certain deductions when related entities or hobby loss rules were involved. Even when

41 T.C. Memo. 2011-192.

42 459 Fed. Appx. 389 (5th Cir. 2012), *aff'g* T.C. Memo. 2010-128.

43 Treas. Reg. § 1.162-1(a) provides that insurance premiums may be deducted as business expenses.

taxpayers were careful to establish complex business structures and document transactions conducted between related entities, the courts were not convinced that the entity claiming deductions was an active trade or business. Without assurances that their sophisticated business structures will yield the anticipated deductions, business taxpayers may be less willing to engage in such transactions. The IRS may find it useful to reach out to business tax advisors to ensure that they are aware of the IRS's willingness to litigate such cases.

MLI #5

Gross Income Under IRC § 61 and Related Sections

SUMMARY

When preparing tax returns, taxpayers must report gross income for the taxable year to determine the tax they must pay. The reporting of gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress.[1] For this report, we reviewed 92 cases decided between June 1, 2011, and May 31, 2012. The majority of gross income cases this year involved taxpayers failing to report items of income, including some specifically mentioned in Internal Revenue Code (IRC) § 61 such as wages,[2] interest,[3] dividends,[4] and annuities.[5]

PRESENT LAW

IRC § 61 broadly defines gross income as "all income from whatever source derived."[6] The U.S. Supreme Court has defined gross income as any accession to wealth.[7] However, over time, Congress has carved out numerous exceptions to and exclusions from this broad definition and has based other elements of tax law on the definition.[8]

ANALYSIS OF LITIGATED CASES

In the 92 opinions issued by the federal courts involving gross income and reviewed for this report, gross income issues most often fall into two categories: (1) what is included in gross income under IRC § 61, and (2) what can be excluded under other statutory provisions. A detailed list of all cases analyzed appears in Table 5 of Appendix III.

In 39 cases (about 42 percent), taxpayers were represented, while the rest were *pro se* (without counsel). Eleven of the 39 represented taxpayers (about 28 percent) prevailed in full or in part in their cases. Five of the 53 *pro se* taxpayers (about nine percent) prevailed in full or in part. Overall, taxpayers prevailed in full or in part in 16 of 92 cases (about 17 percent).

Drawing on the full list in Table 5 of Appendix III, we here discuss cases involving damage awards, loan proceeds, and discharge of indebtedness, because they present significant

1 *See, e.g.*, National Taxpayer Advocate 2010 Annual Report to Congress 467–471; National Taxpayer Advocate 2011 Annual Report to Congress 637–642.

2 Internal Revenue Code (IRC) § 61(a)(1). *See, e.g., Caton v. Comm'r*, T.C. Memo. 2012-92.

3 IRC § 61(a)(4). *See, e.g., Megibow v. Comm'r*, T.C. Memo. 2011-211.

4 IRC § 61(a)(7). *See, e.g., Juha v. Comm'r*, T.C. Memo. 2012-68.

5 IRC § 61(a)(9). *See, e.g., McNeil v. Comm'r*, 467 Fed.Appx. 778 (10th Cir. 2012).

6 IRC § 61(a).

7 *Comm'r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955) (interpreting § 22 of the Internal Revenue Code of 1939, the predecessor to IRC § 61).

8 *See, e.g.*, IRC §§ 104 (compensation for injuries or sickness); 105 (amounts received under accident and health plans); 108 (income from discharge of indebtedness); 6501(limits on assessment and collection, determination of "substantial omission" from gross income).

issues litigated in multiple cases. We also discuss individual cases of first impression decided in the federal appeals courts, concerning parsonage income for a second home and a change of accounting method.

Damage Awards

The taxation of damage awards continues to generate litigation. This year, at least ten taxpayers challenged the inclusion of settlement proceeds or arbitration awards in gross income, and the IRS won every case. IRC § 104(a)(2) specifies that damage awards and settlement proceeds[9] are taxable as gross income unless the award was received "on account of personal physical injury or physical sickness."[10] Congress added the "physical injury or physical sickness" requirement in 1996;[11] until then, the word "physical" did not appear in the statute. The legislative history of the 1996 amendments to IRC § 104(a)(2) states that

> [i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness...[but] emotional distress is not considered a physical injury or physical sickness.[12]

Thus, a court cannot consider damage awards for emotional distress to be excludible from income, even if the emotional distress has resulted in "insomnia, headaches, [or] stomach disorders."[13] To justify exclusion from income under IRC § 104, the taxpayer must show that settlement proceeds are in lieu of damages for physical injury or sickness.[14]

Six taxpayers argued that their settlement awards compensated, in whole or in part, for personal physical injuries or physical sickness. For example, in *Ahmed v. Commissioner*,[15] the taxpayer alleged that harassment he suffered while employed contributed to his heart attack shortly after his employer terminated him.[16] The taxpayer was rehired, and on his first day back on the job, "he was exposed to chemicals that made him nauseated and dizzy and that required him to visit the emergency room on the same day."[17] Under the settlement agreement, the taxpayer agreed to retire and release his employer from all claims, including "personal injuries." The taxpayer argued the employer intended the settlement to compensate him for physical injuries. The Tax Court found the settlement payment

9 *See* Treas. Reg. § 1.104-1(c)(1) (damages received, for purposes of IRC § 104(a)(2), "means an amount received (other than workers' compensation) through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution").

10 IRC § 104(a)(2).

11 Pub. L. No. 104-188, § 1605(a), 110 Stat. 1755, 1838 (1996).

12 H.R. Conf. Rep. No. 104-586, at 143-44 (1996).

13 H.R. Conf. Rep. No. 104-737, at 301 (1996). The exclusion does apply to damages received as reimbursement for amounts paid for medical care attributable to emotional distress for which deductions are allowed under IRC § 213. IRC § 104(a)(2).

14 *See, e.g., Green v. Comm'r*, 507 F.3d 857 (5th Cir. 2007), *aff'g* T.C. Memo. 2005-250.

15 T.C. Memo. 2011-295, *appeal docketed*, No. 12-11337 (11th Cir. Mar. 5, 2012).

16 *Id*.

17 *Id*.

was severance pay, and not attributable to physical injuries, because the taxpayer agreed to retire from that job.[18]

The courts place the burden on the taxpayer to prove settlements were for personal physical injuries or sickness. In *Reesink v. Commissioner*,[19] the taxpayer filed suit accusing his brother "of attacking and strangling him on several occasions as well as poisoning him by pouring cleaning fluid into his drinking water."[20] The brothers each owned one-half of an apartment building, where the alleged acts occurred. The taxpayer settled by agreeing to cooperate in the joint sale of the apartment building and for "$60,000 as payment in full for his claims arising from the events described in his complaint."[21] The complaint did not allege physical injuries. The Tax Court found that the claims could be for emotional distress, and because the taxpayer failed to meet his burden of proof, he must treat the settlement income as taxable.[22]

Loan Proceeds

Loan proceeds are excludable from the borrower's gross income.[23] Courts consider several factors to determine whether the parties intended to make a bona fide loan (*i.e.*, money has been advanced and must be repaid); no single factor is dispositive.[24] Some of the factors include whether the parties document the loan, the lender charges interest, and the borrower repays the loan on a fixed payment schedule.[25]

Two taxpayers convinced the Tax Court that they received nontaxable loan proceeds. In *Bailey v. Commissioner*,[26] the taxpayer received stock from a client. He agreed to hold the stock in trust for the benefit of his client, but used some of it as collateral for $3 million in loans, which he guaranteed and repaid one year later.[27] Mr. Bailey argued his use of the stock was not taxable, because he eventually transferred the stock and its proceeds to the federal government in forfeiture of his client's assets.[28] The Tax Court rejected the IRS's argument that the use of stock as collateral constitutes income in an amount equal to the value of the stock or, alternatively, the value of the loan proceeds.[29]

18 T.C. Memo. 2011-295.

19 *Reesink v. Comm'r*, T.C. Memo. 2012-118.

20 *Id.*

21 *Id.*

22 *Id.* For a discussion on the law treating taxpayers differently according to illness, see National Taxpayer Advocate 2009 Annual Report to Congress 351-356 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*).

23 *Comm'r v. Indianapolis Power & Light Co.*, 493 U.S. 203, 207-208 (1990) (quotation omitted).

24 *Welch v. Comm'r*, 204 F.3d 1228, 1230 (9th Cir. 2000); *Frierdich v. Comm'r*, 925 F.2d 180, 182 (7th Cir. 1991).

25 *Moore v. United States*, 412 F.2d 974, 978 (5th Cir. 1969).

26 T.C. Memo. 2012-96.

27 *Id.*

28 *Id.*

29 *Id.*

In *Kaider v. Commissioner*,[30] the taxpayer received four checks totaling $21,500 as loan proceeds in 2006 from a company that he assisted. The Tax Court analyzed several factors and found that each check constituted a loan. The factors included whether:

- The taxpayer entered a loan agreement for each loan;
- The company had not deducted the payments as compensation;
- The taxpayer's services were insignificant compared to the loan amounts; and
- The company owner's testimony was not credible when compared to the taxpayer's testimony.[31]

The Tax Court agreed with the taxpayer and held that the checks were bona fide loans excludable from the taxpayer's gross income.[32]

Discharge of Indebtedness

We reviewed six cases in which taxpayers disputed the IRS's determination that a discharge of indebtedness was taxable income, and in two of the cases prevailed in full. A taxpayer must include income from discharge of indebtedness when calculating gross income,[33] but can exclude it in certain circumstances. In this regard, IRC § 108(a) provides, subject to limitations, that a taxpayer may exclude income from the discharge of indebtedness if the discharge occurs in bankruptcy, or when the taxpayer is insolvent, or if the indebtedness is qualified farm or business real estate debt or qualified principal residence indebtedness.[34] The creditor issues a Form 1099-C, *Cancellation of Debt,* to the taxpayer for cancelled debts of $600 or more.[35]

The issuance of a Form 1099-C is not dispositive of whether or when a debt is discharged.[36] A debt is "deemed" to have been discharged, and a Form 1099-C is required, if (and only if) an "identifiable event" has occurred.[37] For example, in *Kleber v. Commissioner*, the Tax Court held that the taxpayers (a husband and wife) were not liable for cancellation of indebtedness income (COI) reported by a third party on Form 1099-C in 2006 because the "identifiable event" occurred in an earlier year for which a Form 1099-C had not been issued.[38] Ms. Kleber had agreed to lease land from the Navy from 1997 to 2001 but in 1998 informed the Navy that she could not comply with the lease, and did not make any subsequent payments. In 1999, the government sent her several letters demanding past-due rent

30 T.C. Memo. 2011-174.

31 *Id*.

32 *Id*.

33 IRC § 61(a)(12).

34 IRC § 108(a)(1)(A)-(E).

35 IRS, Instruction 1099-A & C, *Instructions for Forms 1099-A and 1099-C* 2 (2012).

36 T.C. Memo. 2011-233.

37 Treas. Reg. § 1.6050P-1(a). The only exception is that a creditor may, at its discretion, report an actual discharge of indebtedness that occurs before an identifiable event occurs. Treas. Reg. § 1.6050P-1(b)(3).

38 *Kleber v. Comm'r*, T.C. Memo. 2011-233.

and interest. For the next seven years, responsibility for collecting the debt shifted among different government departments, but none took any visible collection action.[39]

In 2006, the government issued Ms. Kleber a Form 1099–C reflecting COI, which she did not report on her 2006 return. After an examination, the IRS asserted a deficiency and a penalty. Ms. Kleber petitioned the Tax Court, arguing that the amount of COI income for 2006, if there was any, was incorrect and the debt should have been discharged in an earlier year.

There is a rebuttable presumption that an "identifiable event," requiring a creditor to issue Form 1099-C, occurred during a calendar year if a creditor has not received a payment on an indebtedness at any time during a preceding "testing period."[40] The testing period is 36 months, plus the number of months during which the creditor was precluded from engaging in collection activity under local law.[41] The creditor can rebut the presumption that an identifiable event took place, triggering its obligation to issue a Form 1099-C, by showing it engaged in significant collection activity (more than just automated mailing or other nominal acts) during the last 12 months of the testing period.[42] According to the Tax Court, the government failed to produce any evidence that active collection activity occurred after 1999. As a result, the IRS did not rebut the presumption that a Form 1099-C for this debt was required in 2002, at the end of the 36-month testing period, rather than in 2006. Thus, the Tax Court held that there was no COI in 2006, and the taxpayers had no obligation to report the income on their 2006 return.[43]

Parsonage Income

The Eleventh Circuit Court of Appeals reversed a decision by a divided Tax Court that held parsonage income for a second home was excludable from gross income.[44] IRC § 107 provides an exclusion from income for the rental value of parsonages. A minister of the gospel may exclude from gross income compensation for the rental value of a home provided to him or her, or the rental allowance, to the extent the payment does not exceed the

39 T.C. Memo. 2011-233.

40 Treas. Reg. § 1.6050P-1(b)(2)(iv).

41 *Id*.

42 *Id*.

43 Because the 36-month testing period allows a creditor to issue (or threaten to issue) a Form 1099-C even though it is not actually discharging a debt, a creditor can collect the debt even as the IRS proposes additional tax due to the reported cancellation of the same debt. The National Taxpayer Advocate has recommended removing the 36-month testing period as an "identifiable event." *See* National Taxpayer Advocate 2010 Annual Report to Congress 383 (Legislative Recommendation: *Remove the 36-Month "Testing Period" that May Trigger Cancellation of Debt Reporting*). The recommendation would not harm taxpayers like the Klebers who can point to another "identifiable event" that occurred in a year before the Form 1099-C was issued, such as "discharge pursuant to a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge the debt." Treas. Reg. § 1.6050P-1(b)(2)(i)(G). Moreover, the recommendation would not affect the availability of exclusions under IRC § 108(a)(1)(A)-(E), such as for insolvency and for qualified farm indebtedness.

44 *Comm'r v. Driscoll*, 669 F.3d 1309 (11th Cir. 2012), *rev'g and remanding Driscoll v. Comm'r*, 135 T.C. 557 (2010). *See* National Taxpayer Advocate 2011 Annual Report to Congress 640–641.

fair rental value of the home, including furnishings and components such as a garage, plus utilities.[45]

In *Commissioner v. Driscoll*,[46] the taxpayer-husband was a minister who received a parsonage allowance as part of his compensation from his employer, a tax-exempt organization under IRC § 501(c)(3). Mr. Driscoll excluded the allowance from his income under IRC § 107 and used the allowance to provide a primary residence and a second lakefront home for his family. The IRS determined a deficiency in income for the portion of the parsonage allowance used for the lakefront home in each of the tax years at issue.[47] The taxpayers petitioned the Tax Court, and the IRS took the position that the plain language of IRC § 107 permits the exclusion of the allowance up to the amount used to provide "a home," indicating a singular residence.[48]

The Tax Court majority relied on the Dictionary Act, 1 U.S.C. § 1, for the proposition that singular terms (here, "a home") in the Internal Revenue Code also include plural forms ("homes").[49] However, the Dictionary Act does not apply if the context indicates otherwise.[50] The Eleventh Circuit found that "home" has a singular connotation as "one's principal place of residence."[51] The legislative history is consistent with this narrow reading.[52] Finally, the Court explained that income exclusions should be narrowly construed and any ambiguity in § 107 should be resolved in favor of the IRS.[53]

Change of Accounting Method

If the IRS determines that a method of accounting does not clearly reflect income, the computation of taxable income shall be made under a method that, in the opinion of the Secretary, does clearly reflect income.[54] The IRS can impute a change in accounting method to assess additional taxes in the current tax year to disallow deductions taken in prior closed tax years when taxpayers have failed to adopt an accounting method required under the law.[55] The IRC disallows deductions to a person who transacts business with a related party, who because of its accounting method does not include the amount of the transaction in its gross income. Related parties must match their income and deductions in the same taxable year.[56]

45 IRC § 107.

46 669 F.3d 1309.

47 *Id*. at 1310.

48 *Driscoll v. Comm'r*, 135 T.C. 557, 563-64 (2010).

49 *Id*. at 566.

50 669 F.3d at 1311.

51 *Id*. at 1311–1312.

52 *Id*. at 1312 (quoting S. Rep. No. 83-1622, at 186 (1954); H.R. Rep. No. 83-1337, at A35 (1954)).

53 *Id*. at 1312–1313.

54 IRC § 446(b).

55 IRC § 481.

56 IRC § 267(a)(2).

In *Bosamia v. Commissioner*,[57] the Bosamias owned two related S corporations: an importer and a music seller. The music seller purchased cassettes from the importer on credit, creating an account payable. The music seller deducted from its taxable income the cost of goods sold, equal to the annual increase in the account payable under the accrual method of accounting. However, the importer did not report the corresponding account receivable as income because the importer accounted for income on the cash basis.[58] The IRS issued a notice of deficiency, disallowing the music seller's deductions from 1998 through 2004, because the importer did not include the receivable in gross income. The IRS argued that the adjustment to the deductions over several tax years should be treated as an adjustment under IRC § 481 for a change in accounting method in the tax year before the court, effectively reopening the expired assessment statute of limitations for the earlier tax years.[59] The Fifth Circuit Court of Appeals agreed with the IRS and affirmed the Tax Court's decision.

CONCLUSION

Taxpayers litigate many of the same gross income issues year after year. The courts broadly define gross income, and narrowly construe exceptions. Most cases considering the inclusion of income under IRC § 61 were decided for the IRS. A major source of litigation was the inclusion of damage awards. The National Taxpayer Advocate has previously recommended a legislative change that would clarify the tax treatment of court awards and settlements by permitting taxpayers to exclude any payments received as a settlement or judgment for mental anguish, emotional distress, or pain and suffering.[60] One exception to decisions favoring the IRS was in the area of cancellation of debt income, where taxpayers successfully relied on a presumption in a Treasury Regulation that required their creditor to report cancellation of debt income in an year earlier than the year at issue. Because the presumption harms taxpayers by allowing a creditor to continue to collect a debt that has been reported to the IRS as discharged, giving rise to cancellation of debt income, the National Taxpayer Advocate has recommended removing the presumption from the regulation. The recommendation leaves undisturbed other bases for excluding or contesting the reported cancellation of debt income.

57 *Bosamia v. Comm'r*, 661 F.3d 250 (5th Cir. 2011), *aff'g* T.C. Memo. 2010-218.

58 661 F.2d at 252.

59 *Id*. at 256-258.

60 National Taxpayer Advocate Annual 2009 Annual Report to Congress 351-356 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*).

MLI #6

Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654

SUMMARY

We reviewed 74 decisions issued by federal courts from June 1, 2011, to May 31, 2012, regarding the additions to tax for failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1), failure to pay an amount shown as tax on a return under IRC § 6651(a)(2), failure to pay estimated tax under IRC § 6654, or some combination of the three.[1] The phrase "addition to tax" is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty and the estimated tax penalty. Seventeen cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties, three cases involved only the estimated tax penalty, five cases involved only the failure to pay penalty, and 34 cases involved only the failure to file penalty.

The failure to file and failure to pay penalties shall be imposed unless the taxpayer can demonstrate that the failure is due to reasonable cause and not willful neglect.[2] The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions.[3] Most taxpayers in the cases we analyzed were unable to avoid the penalty.

PRESENT LAW

Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before its due date (including extensions) will be subject to a five percent penalty for each month or partial month the return is late, up to a maximum of 25 percent, unless the failure is due to reasonable cause and not willful neglect.[4] The penalty is based on the amount of tax due, minus any credit the taxpayer is entitled to receive and any payment made by the due date.[5] The failure to file penalty applies to income, estate, gift, employment and self-employment, and certain excise tax returns.[6] To establish reasonable cause, the taxpayer must show that he or she exercised ordinary business care and prudence but was still unable to file by the due date.[7]

1 IRC § 6651(a)(3) imposes an addition to tax for failure to pay a tax liability not shown on a return. However, because only a small number of cases involved this penalty, we did not include it in our analysis.

2 IRC § 6651(a)(1), (a)(2).

3 IRC § 6654(e).

4 IRC § 6651(a)(1). The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

5 IRC § 6651(b)(1).

6 IRC § 6651(a)(1).

7 Treas. Reg. § 301.6651-1(c)(1).

IRC § 6651(a)(2) applies to a taxpayer who fails to pay an amount shown as tax on his or her return. When both the failure to file and failure to pay penalties are imposed for the same month, the amount of the failure to pay penalty reduces the amount of the failure to file penalty.[8] Unless the taxpayer can show that the failure to pay was due to reasonable cause and not willful neglect, the failure to pay penalty accrues at a rate of 0.5 percent per month on the unpaid balance for as long as the balance due remains unpaid, up to a maximum of 25 percent of the amount due.[9] The failure to pay penalty applies to income, estate, gift, employment and self-employment, and certain excise tax returns.[10] To establish reasonable cause, the taxpayer must show that he or she exercised ordinary business care and prudence but was still unable to pay by the due date, or that payment on the due date would cause undue hardship.[11] Courts will consider "all facts and circumstances of the taxpayer's financial situation" to determine whether the taxpayer exercised ordinary business care and prudence.[12]

IRC § 6654 imposes a penalty on any underpayment of estimated tax by an individual.[13] The law requires four installments per taxable year, each generally 25 percent of the annual payment.[14] The required annual payment is generally the lesser of 90 percent of the tax shown on the return for the current taxable year or 100 percent of the tax shown on the return for the previous year.[15] The IRS will determine the amount of the penalty by applying the underpayment rate according to IRC § 6621 to the amount of the underpayment for the period of the underpayment.[16]

The estimated tax penalty applies to returns of individuals and certain estates and trusts.[17] To avoid the penalty, the taxpayer has the burden of proving that one of the following exceptions applies:

- The tax due (after taking into account any federal income tax withheld) is less than $1,000;[18]
- The preceding taxable year was a full 12 months, the taxpayer had no liability for the preceding taxable year, and the taxpayer was a U.S. citizen or resident throughout the preceding taxable year;[19]

8 IRC § 6651(c)(1).

9 If an installment agreement is in place, the penalty will continue accruing at the lower rate of 0.25 percent rather than 0.5 percent of the tax shown. IRC § 6651(h).

10 IRC § 6651(a)(2).

11 Treas. Reg. § 301.6651-1(c)(1). Even when a taxpayer shows undue hardship, the regulations require him or her to prove reasonable cause.

12 *Id. See, e.g., East Wind Indus., Inc. v. U.S.*, 196 F.3d 499, 507 (3d Cir. 1999).

13 IRC § 6654(a).

14 IRC § 6654(c)(1), (d)(1)(A).

15 IRC § 6654(d)(1)(B).

16 IRC § 6654(a).

17 IRC § 6654(a), (l).

18 IRC § 6654(e)(1).

19 IRC § 6654(e)(2).

- The IRS determines that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience;[20] or
- The taxpayer retired after reaching age 62 or became disabled in the taxable year for which estimated payments were required or in the taxable year preceding that year, and the underpayment was due to reasonable cause and not willful neglect.[21]

In any court proceeding, the IRS has the burden of producing sufficient evidence that it appropriately imposed the failure to file, failure to pay, or estimated tax penalties.[22]

ANALYSIS OF LITIGATED CASES

We analyzed 74 opinions issued between June 1, 2011, and May 31, 2012, where the failure to file penalty, failure to pay penalty, or estimated tax penalty (or all three) were in dispute. All but six of these cases were litigated in the United States Tax Court. A detailed list appears in Table 6 in Appendix III. Forty-three cases involved individual taxpayers and 31 involved businesses (including individuals engaged in self-employment or partnerships). Of the 52 cases in which taxpayers appeared *pro se* (without counsel), taxpayers prevailed in full in two cases, and four resulted in split decisions. Of the 22 cases in which taxpayers appeared with representation, taxpayers prevailed in full in only one case, and one was resolved as a split decision.

Failure to File Penalty

A common basis for the courts' rulings against taxpayers on the failure to file penalty was the lack of evidence that the failure was due to reasonable cause. In fact, in 67 of the 74 cases (91 percent), the taxpayers did not present any evidence of reasonable cause. When taxpayers did present evidence in defense of their failures to file by the due date (or at all), the arguments included the following.

Medical Illness

Depending on the facts and circumstances, a medical illness may establish reasonable cause for failing to file, if the taxpayer can show incapacitation to such a degree that he or she could not file a return on time.[23] The taxpayer in *In re Williams* did not establish reasonable cause when the Bankruptcy Court found that his knee surgeries had not debilitated him so much that he had reasonable cause for filing his return late.[24]

20 IRC § 6654(e)(3)(A).

21 IRC § 6654(e)(3)(B).

22 *Higbee v. Comm'r*, 116 T.C. 438, 446 (2001) (quoting IRC § 7491(c)). An exception to this rule relieves the IRS of this burden where the taxpayer's petition fails to state a claim for relief from the penalty, such as where the taxpayer only makes frivolous arguments. *Funk v. Comm'r*, 123 T.C. 213 (2004).

23 *Williams v. Comm'r*, 16 T.C. 893, 905-06 (1951) (interpreting § 291 of the 1939 Code, a predecessor to IRC § 6651), *acq.*, 1951-2 C.B. 1. *See, e.g., Harbour v. Comm'r*, T.C. Memo. 1991-532 (finding reasonable cause for failing to timely file because the taxpayer was in a coma the month before the due date of his tax return).

24 109 A.F.T.R.2d (RIA) 2365 (Bankr. D. Neb. 2012).

A court also may find reasonable cause where a taxpayer cannot file on time because he or she is caring for another person.[25] For example, in *Bailey v. Commissioner,* the Tax Court determined a taxpayer had reasonable cause for missing a filing deadline during the year in which his wife lost her struggle with a terminal illness.[26] The taxpayer filed his 1998 return 50 days after his wife died in October 1999, and filed his 1999 and 2000 returns a few months late. The court found that the taxpayer had reasonable cause for the late filing of the 1998 return because he spent most of his time at his wife's bedside.

Reliance on Agent

The United States Supreme Court, in *United States v. Boyle,*[27] held that taxpayers have a nondelegable duty to file a return on time, and a taxpayer's reliance on an agent does not excuse a failure to comply with a known filing requirement. In *Greenwald v. Commissioner,*[28] the taxpayer argued that he reasonably relied on an accounting firm to request an extension of time to file his 2005 return. The firm told the taxpayer that its policy was to request extensions for its customers without being prompted, but he later discovered the extension had not been filed, and he filed his own return on January 12, 2007. The Tax Court determined there was not enough evidence to show reasonable cause for the late filing because the taxpayer knew he would need an extension and did not file one, and under *Boyle* the duty to file could not be delegated to an attorney or accountant.[29] The court also noted that the taxpayer failed to present evidence proving the date when he gave his tax return information to the accounting firm, and the witness from the firm could not recall the contents of the taxpayer's file.

A taxpayer may establish reasonable cause if he or she can prove reasonable reliance on a professional tax advisor, or that the taxpayer made a good-faith effort to ascertain return filing requirements.[30] In order to reasonably rely on the advice of a tax professional, the taxpayer must present evidence of the professional's expertise and show that the taxpayer provided him or her with all necessary and accurate information.[31] In *Cahill v. Commissioner*, the taxpayer was unable to establish reasonable cause for her failure to file when she claimed reliance on an attorney and a stockbroker.[32] She claimed the attorney and the broker told her she did not have to file, but she did not provide any written opinion from either of them, and failed to establish they were competent tax advisors.

25 *Tabbi v. Comm'r*, T.C. Memo. 1995-463 (determining reasonable cause existed for the late filing of a joint return where the taxpayers' son had heart surgery and the taxpayers were continuously at the hospital for four months surrounding the due date of the return).

26 T.C. Memo. 2012-96.

27 469 U.S. 241 (1985).

28 T.C. Memo. 2011-239.

29 *Greenwald*, T.C. Memo. 2011-239.

30 *Estate of La Meres v. Comm'r*, 98 T.C. 294, 315-17 (1992) (citations omitted).

31 *Id*.

32 T.C. Memo. 2011-203.

"Zero Return" Filers and Other Frivolous Arguments

Under the longstanding four-part test articulated in *Beard v. Commissioner*,[33] a valid return must:

1. Purport to be a return;
2. Be signed under penalties of perjury;
3. Contain sufficient data to calculate the tax liability; and
4. Represent an honest and reasonable attempt to satisfy the requirements of the tax laws.

Each year, some taxpayers claim they have no obligation to pay taxes by filing returns reporting zero income when they have earned substantial wages accurately reported on a Form W-2.[34] A "zero" return does not constitute a tax return under the *Beard* test because it is devoid of financial data and does not provide sufficient information to calculate the tax liability.[35] Thus, when the taxpayer in *Richmond v. Commissioner* filed a return containing all zeros, the Tax Court sustained the failure to file penalty.[36]

In six cases where the IRS had asserted the failure to file penalty, the courts also imposed the IRC § 6673 penalty for making frivolous arguments.[37] Among the frivolous argument cases is one where the taxpayer argued that as a resident of the United States, he *may* choose to file a return, or he *may* choose not to do so, and he chose the latter.[38] The Tax Court held him liable for the failure to file penalty, and also imposed a $1,000 penalty under IRC § 6673.

Failure to Pay an Amount Shown Penalty

A taxpayer can file his or her return by the applicable due date and still be liable for a penalty if the amount shown on the return is not paid. In cases where taxpayers disputed that they were subject to the failure to pay penalty, many of the justifications were similar to those used for the failure to file penalty under IRC § 6651(a)(1). To refute the failure to pay penalty, individual taxpayers unsuccessfully argued medical illness[39] or reliance on an agent.[40]

33 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

34 *See, e.g.*, Parker v. Comm'r, T.C. Memo. 2012-66 (concluding that there was no evidence of reasonable cause presented when the taxpayer reported all "zeros" on his return and offered only frivolous arguments).

35 *See Turner v. Comm'r*, T.C. Memo. 2004-251, and the numerous cases cited therein.

36 T.C. Memo. 2011-251, *aff'd*, 2012 U.S. App. LEXIS 17059 (10th Cir. Aug. 15, 2012).

37 *See* Most Litigated Issue: *Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions, infra*.

38 *Garber v. Comm'r*, T.C. Memo. 2012-47, 2 (emphasis added).

39 *Nasir v. Comm'r*, T.C. Memo. 2011-283.

40 *Cahill v. Comm'r*, T.C. Memo. 2011-203.

Some business taxpayers successfully argued they had reasonable cause for their failure to pay because they exercised ordinary business care and prudence.[41] For example, the taxpayer in *Custom Stairs & Trim, Ltd. v. Commissioner*, a small construction business in Florida, was assessed the IRC § 6651(a)(2) penalty when it failed to pay the required employment tax for the second quarter of 2008.[42] This case came to the Tax Court for judicial review of the IRS Office of Appeals determination after a Collection Due Process (CDP) hearing under IRC §§ 6320 and 6330.[43] The IRS argued that the mere inability to pay, combined with the business's payment of other creditors instead of the IRS, can *never* constitute reasonable cause for abatement of employment tax penalties. The court disagreed, stating that "a majority of the Courts of Appeals that have decided this issue determined 'that financial hardship can, under certain circumstances, justify failure to pay . . . employment taxes,'"[44] and criticized the IRS for "essentially argu[ing] that if Custom Stairs cannot afford to make its tax payment timely it should go out of business."[45] The court expressly rejected the IRS's position, stating: "Both the economy and the federal fisc are negatively impacted by such an approach — the amount of money flowing into the economy and the fisc is reduced as a result of increased unemployment, idle buildings and plants, and decreased sales of goods and services."[46]

To determine whether the taxpayer had reasonable cause, the Tax Court referenced Treasury Regulation § 301.6651-1(c)(1), which states that a taxpayer can show reasonable cause if it proves that it "exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship . . . if he paid on the due date."[47] The primary factors showing whether the business exercised ordinary care include (1) the taxpayer's favoring creditors other than the government, (2) the taxpayer's financial decisions, and (3) the taxpayer's willingness to decrease its costs and staff.[48] The court found Custom Stairs' failure to make the quarterly payment was due to Hurricane Ivan, the 2008 economic collapse, and the practical fact of the cascading penalties themselves.[49] It determined that Custom Stairs had exercised ordinary business care and prudence in cutting benefits and payroll, selectively

41 *Custom Stairs & Trim, Ltd., v. Comm'r*, T.C. Memo. 2011-155.

42 *Id*.

43 For a detailed discussion of CDP, see Most Litigated Issue: *Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330, supra*.

44 *Custom Stairs & Trim, Ltd.*, T.C. Memo. 2011-155, 7 (quotation omitted).

45 *Id. at* 8.

46 *Id*. (quoting *East Wind Indus., Inc. v. U.S.*, 196 F.3d 499, 509 (3d Cir. 1999)).

47 Treas. Reg. § 301.6651-1(c)(1).

48 Custom Stairs & Trim, Ltd., T.C. Memo. 2011-155 (citing, *inter alia, Staff It, Inc. v. U.S.*, 482 F.3d 792 (5th Cir. 2007) (additional citations omitted)).

49 The taxpayer paid over to the IRS amounts greater than the employment taxes it owed for that period. However, because the taxpayer did not designate the payments, the IRS characterized the payments as pertaining to a prior quarter. Although failure to pay penalties were assessed for multiple quarters, quarter after quarter funds were applied to the penalties assessed for the prior quarter, and only the second quarter of 2008 remained unpaid at the time of the litigation. *Custom Stairs & Trim, Ltd., T.C.* Memo. 2011-155.

paying business expenses, and even attempting to sell real property to pay the penalties, and thus had reasonable cause.[50]

Estimated Tax Penalty

Courts routinely found taxpayers liable for the IRC § 6654 estimated tax penalty when the IRS proved the taxpayer had a tax liability, had no withholding credits, and made no estimated tax payments for that year, and the taxpayer offered no evidence to refute the IRS's evidence.[51]

The IRS has the burden of production under IRC § 7491(c) to produce evidence that a taxpayer was required to make an annual payment under IRC § 6654(d)(1)(B). We found only two cases where the taxpayer prevailed regarding the estimated tax penalty because of the IRS's failure to put forth evidence that the penalty was appropriate. In *Gleason v. Commissioner*, the Tax Court concluded the taxpayer was not liable for the § 6654 penalty because the IRS failed to introduce evidence necessary for the court to calculate her estimated tax for the 2000 taxable year.[52] The IRS failed to offer evidence that the taxpayer filed a return for the 2000 taxable year or that she owed any tax. The court reasoned that because the taxpayer's 2001 and 2003 returns reported that she owed no tax, assessment of the § 6654 penalty resulted in a penalty equal to 90 percent of zero estimated tax.[53] Therefore, the taxpayer was not liable for a § 6654 penalty for either the 2001 or 2003 taxable years. Similarly, the IRS failed its burden of production for one of the six tax years at issue in *West v. Commissioner*.[54]

CONCLUSION

The United States tax system relies on taxpayers voluntarily filing accurate returns and paying their taxes. Penalties attempt to establish fairness by imposing an additional cost on the noncompliant taxpayer. The penalties for failure to file, failure to pay an amount shown as tax, and failure to pay estimated tax were designed to encourage voluntary compliance and deter noncompliance.[55]

The IRS should determine whether these penalties positively influence compliance as intended, particularly in the case of taxpayers who comply with their filing obligations, although in an untimely manner. If compliance is not significantly improved, then the penalties fail to serve their primary function. Although revenue is generated by the penalties,

50 The court relied on the elaboration of facts provided in the National Taxpayer Advocate's memorandum accompanying a Form 9102, *Taxpayer Assistance Order* issued earlier. *Custom Stairs & Trim, Ltd.*, T.C. Memo. 2011-155.

51 *See, e.g., Caton v. Comm'r*, T.C. Memo. 2012-92; *Plotkin v. Comm'r*, T.C. Memo. 2011-260, *appeal docketed*, No. 12-10620 (11th Cir. Feb. 6, 2012).

52 T.C. Memo. 2011-154.

53 *Gleason v. Comm'r*, T.C. Memo. 2011-154 (citing *Mendes v. Comm'r*, 121 T.C. 308, 324 (2003) (holding that a taxpayer's estimated liability is based on the original return filed rather than the taxpayer's ultimate tax liability or a notice of deficiency).

54 T.C. Memo. 2011-272.

55 *See* Policy Statement 20-1 (formerly P-1-18), IRM 1.2.20.1.1 (June 29, 2004). *See also U.S. v. Boyle*, 469 U.S. 241, 245 (1985) ("Congress' purpose in the prescribed civil penalty was to ensure timely filing of tax returns to the end that tax liability will be ascertained and paid promptly.").

the allowance of a one-time abatement for taxpayers who comply with filing obligations in an untimely manner might reduce litigation without significantly affecting compliance. The National Taxpayer Advocate reiterates her recommendation to implement a one-time abatement of the failure to file penalty for taxpayers who comply with their filing obligations, but in an untimely manner.[56] More broadly, she notes the significance of cases such as *Custom Stairs*, discussed above, which abated the failure to pay penalty where it served no compliance purpose for a taxpayer exercising ordinary business care for payment of its tax liability. Further, she urges a repeal of the failure to pay penalty, which could be replaced by a market rate of interest equal to the rate on an unsecured loan.[57]

56 *See* National Taxpayer Advocate 2001 Annual Report to Congress 188. A provision to waive the failure to file penalty for first-time, unintentional, minor errors was included in the House-passed Taxpayer Protection and IRS Accountability Act of 2003. *See* H.R. 1528, 108th Cong. § 106 (2003). Although the IRS has provided for a one-time administrative waiver of the failure to file penalty in IRM 20.1.1.3.6.1 (Nov. 29, 2011), the National Taxpayer Advocate continues to recommend a statutory waiver similar to IRC § 6656(c).

57 *See* National Taxpayer Advocate 2001 Annual Report to Congress 182.

MLI #7

Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

SUMMARY

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in a U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien or subject any of the delinquent taxpayer's property to the payment of the tax. We identified 48 opinions issued between June 1, 2011, and May 31, 2012 that involved civil actions to enforce liens under IRC § 7403. The courts affirmed the position of the United States in all but two cases; taxpayers prevailed in one case; and one other resulted in a split opinion. Over the four years that this issue has appeared as a Most Litigated Issue, the number of cases identified has remained consistent, with the exception of 2009 when 61 cases were identified.[1]

PRESENT LAW

IRC § 7403 specifically authorizes the United States to enforce a federal tax lien with respect to a taxpayer's delinquent tax liability, or to subject any property, right, title, or interest in the property of the delinquent taxpayer to the payment of a liability, by initiating a civil action against the taxpayer in the appropriate U.S. District Court.[2] All persons holding liens or claiming any interest in the taxpayer's property should be named as parties to the action.[3] The nature of a taxpayer's legal interest in the property subject to a lien is determined by the law of the state where the property is located.[4] However, once it is determined that a delinquent taxpayer has an interest in the property, federal law controls whether the property is exempt from attachment.[5]

The court may order that the property be sold by an officer of the court and the proceeds applied to the delinquent tax liability.[6] However, the court is not required to authorize a forced sale under all circumstances and may exercise limited equitable discretion.[7] In cases

1 See National Taxpayer Advocate 2011 Annual Report to Congress 650-654 (Most Litigated Issue: *Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payments of Tax Under IRC Section 7403*); National Taxpayer Advocate 2010 Annual Report to Congress 483-486 (Most Litigated Issue: *Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payments of Tax Under IRC Section 7403*); National Taxpayer Advocate 2009 Annual Report to Congress 465-470 (Most Litigated Issue: *Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payments of Tax Under IRC Section 7403*).

2 IRC § 7403(a); Treas. Reg. § 301.7403-1(a). Such action may be initiated regardless of whether a levy has been made.

3 IRC § 7403(b).

4 *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985).

5 *United States v. Rodgers*, 461 U.S. 677 (1983). Similarly, federal tax liens can attach to property exempt from the reach of creditors under state law, including property held by a delinquent taxpayer as a tenant by the entirety. *United States v. Craft*, 535 U.S. 274 (2002).

6 IRC § 7403(c).

7 *Rodgers*, 461 U.S. at 711.

where the forced sale involves the interests of non-delinquent third parties, a U.S. District Court should consider four factors when determining whether the property should be sold:

1. The extent to which the government's financial interests would be prejudiced if they were relegated to a forced sale of the partial interests of the delinquent taxpayer;
2. Whether the innocent third party with a separate legal interest in the property, in the normal course of events, has a legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or the taxpayer's creditors;
3. The likely prejudice to the third party in personal dislocation costs and inadequate compensation; and
4. The relative character and value of the non-liable and liable interests held in the property.[8]

The United States may bid at the sale of the property when it holds a first lien,[9] but the amount of the bid is limited to the amount of the lien, plus selling expenses.[10] If any of the taxpayer's other creditors institute a foreclosure action on property subject to a federal tax lien and the United States is not a party, the United States may intervene as if it had originally been joined as a party,[11] and may move the case to the U.S. District Court if it was instituted in a state court.[12] However, junior federal tax liens may be effectively extinguished in a foreclosure and sale under state law, even if the United States is not a party to the proceeding.[13] The IRC also specifically authorizes the court to appoint a receiver to enforce the lien, and upon the government's certification that it is in the public interest, the court may appoint a receiver with all powers of a receiver in equity to preserve and operate the property prior to sale.[14]

ANALYSIS OF LITIGATED CASES

We reviewed 48 opinions entered between June 1, 2011, and May 31, 2012, in civil actions to enforce federal tax liens. Table 7 in Appendix III contains a detailed list of those cases. In 22 cases, taxpayers represented themselves (*pro se*), while 26 taxpayers were represented by counsel. Taxpayers with representation received full relief in one case and partial relief in another, while *pro se* taxpayers did not receive relief in any case.

8 *Rodgers*, 461 U.S. at 709–11.

9 IRC § 7403(c).

10 *Id.*

11 IRC § 7424; 28 U.S.C. § 2410.

12 28 U.S.C. § 1444. However, if the application of the United States to intervene is denied, the adjudication will have no effect upon the federal tax lien on the property. IRC § 7424.

13 *United States v. Brosnan*, 363 U.S. 237 (1960).

14 IRC §§ 7403(d) and 7402(a).

The courts ruled on the appropriateness of foreclosure in all 48 cases, with the government prevailing fully in 46.[15] For example, in *United States v. Rivetts*,[16] the court considered whether it was appropriate to order the foreclosure of the taxpayers' residence. First, because the taxpayers alleged they had never received a notice of deficiency as required by the IRC, the court considered whether the government sent the taxpayer a notice for each assessment and found that it had.[17] Next, the court considered whether the suit began prior to the period of collection expiring and found this requirement had also been met.[18] The court then determined the taxpayers had failed to show that tax liabilities assessed against them were incorrect and had not paid the liabilities.[19] Finally, the court considered whether it should exercise its equitable discretion and prohibit the foreclosure sale because of the hardship it would cause to the extended family living with the taxpayers. The court concluded that the sale of the residence was appropriate even though it might result in dislocation costs and inconvenience to the family.

Tax liens can attach not only to proceeds of the sale of encumbered property but also to new property purchased with the proceeds. In *United States v. McCullough*,[20] the court allowed the government to foreclose upon real property purchased with the proceeds from the sale of the original encumbered property. In that case, the taxpayer transferred her residence to her daughter in exchange for $1.00 and "natural love and affection." At the time, federal tax liens attached to the property as the taxpayer had outstanding liabilities, but no notice of federal tax lien (NFTL) had been filed. The daughter later transferred the property to herself and her husband, eventually selling it and using the proceeds to buy a new home. The court found the original transfer to the daughter was made without adequate consideration. Thus, the daughter was not considered a *bona fide* purchaser, so the transfer to her did not extinguish the tax liens.[21] Because the liens encumbered the residence, they would follow any property substituted for the residence provided the chain of substitution could be traced. Thus, the court ordered foreclosure of the new property, noting that tax

15 In seven cases, United States Courts of Appeals affirmed the trial courts' decisions in favor of the government. *See United States v. Barczyk*, 434 Fed. Appx. 488 (6th Cir. 2011) (per curiam), *aff'g* 697 F. Supp. 2d 789 (E.D. Mich. 2010), *cert. denied*, 132 S. Ct. 1118 (2012); *United States v. Burnett*, 452 Fed. Appx. 569 (5th Cir. 2011), *aff'g* 106 A.F.T.R.2d (RIA) 6699 (S.D. Tex. 2010); *United States v. Howard*, 442 Fed. Appx. 262 (9th Cir. 2011), *aff'g* 102 A.F.T.R.2d (RIA) 5601 (D. Ariz. 2008); *United States v. Springer*, 427 Fed. Appx. 650 (10th Cir. 2011), *aff'g* 105 A.F.T.R.2d (RIA) 1192 (N.D. Okla. 2010); *Ansel Capital Inv., LLC v. United States*, 448 Fed. Appx. 709 (9th Cir. 2011), *aff'g* 2010 U.S. Dist. LEXIS 41977 (D. Mont. 2010); *United States v. Black*, 109 A.F.T.R.2d (RIA) 2282 (9th Cir. 2012), *aff'g* 106 A.F.T.R.2d (RIA) 5320 (E.D. Wash. 2010) and 725 F. Supp. 1279 (E. D. Wash. 2010); *Eckhardt v. United States.*, 109 A.F.T.R.2d (RIA) 1414 (11th Cir. 2012) (per curiam), *aff'g* 2010 U.S. Dist. LEXIS 142176 (S.D. Fla. 2010).

16 109 A.F.T.R.2d (RIA) 2127 (D. Minn. 2012).

17 IRC § 6213.

18 IRC § 6502.

19 In *Rivetts*, the court held that the taxpayers' self-serving affidavits were not sufficient to rebut the presumption of correctness. 109 A.F.T.R.2d (RIA) 2127 (D. Minn. 2012).

20 108 A.F.T.R.2d (RIA) 6732 (W.D. Pa. 2011).

21 If a taxpayer transfers property subject to a federal tax lien to a purchaser before the government files an NFTL, the lien no longer attaches and the purchaser acquires the property free of the lien. IRC § 6323(a). A purchaser is defined in the Code as a person who for adequate consideration acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice. IRC § 6323(h)(6).

liens "follow the property through subsequent transfers until satisfied or barred by the statute of limitations."[22]

In *United States v. Ford*,[23] the court concluded it was appropriate to foreclose upon property held by a third-party purchaser. The case involved a delinquent taxpayer whose real property was sold to another individual by the mortgage company after the taxpayer defaulted on his mortgage. The third party had been informed of the NFTL filing before she bought the property. Although it was the previous owner who owed the debt to the government, the court reasoned that the new owner was not innocent merely because she purchased the home for value and paid for its taxes and insurance. Rather, since she purchased the home with actual and constructive knowledge of the tax lien, the court held that equity did not preclude foreclosure.

In *United States v. Corry Communications*,[24] however, the court determined it was inappropriate to foreclose the tax liens that attached to an active FCC broadcast license. The court reasoned that while there is a private right to receive proceeds from a transfer of the license, the right to operate an FCC-approved broadcast license is a public right and is not property subject to foreclosure under § 7403.

In a number of cases involving property in which non-delinquent third parties held interests, the courts considered the equitable factors set forth by the Supreme Court in *United States v. Rodgers*.[25] For example, in *United States v. Smith*,[26] the court applied the *Rodgers* factors and granted the government's motion for foreclosure of federal tax liens against the taxpayers' home. The court determined that each factor weighed in favor of foreclosure even though the taxpayer's spouse, who did not owe any taxes, was a co-owner of the properties. The court found that the second *Rodgers* factor did not favor relief, as the non-liable spouse had no legally recognized expectation that the property would not be subject to a forced sale, because property held in a tenancy by the entirety[27] can be subjected to a forced sale due to the debts of one spouse. In *United States v. Buaiz*,[28] the court found that all four *Rodgers* factors weighed in favor of the United States and ordered the foreclosure of the property even though the taxpayer's children had an interest in it.

The limited nature of a judge's discretion to deny foreclosure under *Rodgers* is illustrated by *United States v. Winsper*.[29] In that case, the district court reduced the tax assessment against the taxpayer to judgment, but decided not to order the foreclosure of the liens

22 108 A.F.T.R.2d (RIA) 6732 (W.D. Pa. 2011).

23 109 A.F.T.R.2d (RIA) 1201 (E.D. Mich. 2012).

24 108 A.F.T.R.2d (RIA) 6521 (W.D. Pa. 2011), *rejecting* 2011 U.S. Dist. LEXIS 116783 (W.D. Pa. 2011).

25 461 U.S. 677, 710-11 (1983).

26 109 A.F.T.R.2d (RIA) 772 (W.D. Ky. 2012).

27 An "estate by entirety" is a common-law estate in which each spouse is seised of the whole of the property. An estate by entirety is based on the legal fiction that a husband and wife are a single unit. *Black's Law Dictionary* (9th ed. 2009).

28 108 A.F.T.R.2d (RIA) 5856 (E.D. Tenn. 2011).

29 680 F.3d 482 (6th Cir. 2012), *rev'g* 106 A.F.T.R.2d (RIA) 5130 (W.D. Ky. 2010).

attached to the home owned by the taxpayer and his wife. On appeal, the United States Court of Appeals for the Sixth Circuit reviewed the decision for abuse of discretion, and concluded by reversing and remanding the case back to the district court, so that it could reconsider whether to exercise its limited discretion not to order foreclosure of the entire property. The Sixth Circuit held that the district court misapplied two of the four *Rodgers* factors and improperly placed the burden on the government to justify foreclosure. The court explained that the factors do not impose a burden of proof that the government must satisfy before the district court can order a sale, but rather are to be used when a court determines whether to exercise its limited discretion not to order a sale.

Several opinions we reviewed involved foreclosure of federal tax liens against taxpayer property titled in the name of a nominee.[30] The term "nominee" refers to parties that hold legal title to a property while a different party retains all or some of the benefits of the property.[31] In *United States v. Brice*,[32] the IRS assessed taxes against the taxpayer and recorded NFTLs against his properties, of which the most notable were a residence and an airplane hangar, both owned by the taxpayer and his wife. The couple conveyed the properties to themselves as trustees of a family trust, then as trustees conveyed the properties to another trust without consideration, for which the taxpayer served as trustee and chairman. That trust then transferred the properties to yet another trust, for which the taxpayer also served as trustee and chairman. He also paid his personal living expenses out of the trust's bank account. The court held that the taxpayer was the true owner of the residence and the hangar and the trust was simply holding the property as his nominee, since no other person was involved. Accordingly, the liens remained attached to the properties, and the court ordered foreclosure.

Similarly, in *United States v. Sanchez-Martinez*,[33] the government filed an action to foreclose its tax liens against real property held by the taxpayer's sister and the taxpayer's single-member LLC. The court set forth several factors to use in determining whether property was held by a nominee. The court concluded that those holding title to the property were nominees, since the taxpayer declared to a revenue officer that he owned the property, the taxpayer paid taxes on the property, the titleholders were closely related to the taxpayer, and there was no evidence that the titleholders interfered with the taxpayer's use of the property. The court accordingly granted the government's motion for summary judgment and ordered foreclosure.

30 *See, e.g., United States v. Ippolito*, 109 A.F.T.R.2d (RIA) 1083 (M.D. Fla. 2012); *United States v. Ledford*, 109 A.F.T.R.2d (RIA) 1643 (D. Colo. 2012); *United States v. Sanchez-Martinez*, 109 A.F.T.R.2d (RIA) 2183 (E.D.N.C. 2012).

31 *See United States v. Ledford*, 109 A.F.T.R.2d (RIA) 1643 (D. Colo. 2012).

32 109 A.F.T.R.2d (RIA) 1613 (W.D. Mo. 2012).

33 109 A.F.T.R.2d (RIA) 2183 (E.D.N.C. 2012).

CONCLUSION

While the trend in NFTL filings had been generally rising since fiscal year (FY) 2002, in 2011 the IRS announced its "Fresh Start" initiative.[34] The Fresh Start initiative was designed to assist taxpayers with financial burdens by making changes in how the IRS files and withdraws NFTLs.[35] As a result, in FY 2012 NFTL filings decreased to just over 700,000.[36] However, although NFTL filings have decreased, IRS referrals to the Department of Justice of lien foreclosure suits have increased by 26 percent since FY 2010.[37] Due to the increase in referrals to Justice, we anticipate an increase in court opinions on enforcement of IRC § 7403.[38]

34 IRS, Media Relations Office, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process*, IR-2011-20 (Feb. 24, 2011). *See* Statistics of Income Data Books, Table 16b, Delinquent Collection Activities, 2002-2010 and Statistics of Income Data Books, Table 16, Delinquent Collection Activities, 2010-2011.

35 For a full discussion of the National Taxpayer Advocate's concerns about liens *see* Most Serious Problem: *Although the IRS "Fresh Start" Initiative has Reduced the Number of Lien Notices Filed, the IRS has Failed to Determine if its Lien Policies are Clearly Supported by Either Increased Taxpayer Compliance or Revenue, supra*.

36 IRS, Collection Report NO-5000-25 (Oct. 1, 2012).

37 IRS, Small Business/Self Employed Division (SB/SE) SB/SE, Collection Activity Report NO-5000-24, *Levy and Seizure Report* (Oct. 1, 2012). Department of Justice (DOJ), Tax Division, *Suits to Foreclose Tax Lien - Summary by Fiscal Year of Case Receipt* (Oct. 3, 2012). The IRS conducted 605 seizures and referred 221 lien foreclosure suits to the DOJ in FY 2010, and conducted 733 seizures and referred 278 lien foreclosure suits to the DOJ in FY 2012.

38 For a discussion of the National Taxpayer Advocate's proposed amendment to IRC § 7403 *see* Legislative Recommendation: *Amend Code Section 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences, supra.*

MLI #8

Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

SUMMARY

From June 1, 2011, through May 31, 2012, the federal courts issued decisions in at least 38 cases involving the Internal Revenue Code (IRC) § 6673 "frivolous issues" penalty and at least six cases involving an analogous penalty at the appellate level.[1] These penalties are imposed against taxpayers for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.[2] In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future.[3] Nonetheless, we include these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

PRESENT LAW

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.[4] The maximum penalty is $25,000.[5] In some cases, the IRS requests that the Tax Court impose the penalty;[6] in other cases, the Tax Court exercises its discretion, *sua sponte*,[7] to do so.

Taxpayers who institute actions under IRC § 7433[8] for certain unauthorized collection actions can be subject to a maximum penalty of $10,000 if the court determines the taxpayer's position in the proceedings is frivolous or groundless.[9] In addition, IRC § 7482(c)(4),[10]

1 Four cases litigated the issue of the IRC § 6673 penalty at the appellate level and involved an analogous appellate level penalty. Thus, we reviewed a total of 40 cases this year.

2 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts may impose the penalty under IRC § 6673(b)(1). U.S. Courts of Appeals generally impose sanctions under IRC § 7482(c)(4), 28 U.S.C. § 1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.

3 *See, e.g., Campbell v. Comm'r*, T.C. Memo. 2012-82.

4 IRC § 6673(a)(1)(A), (B), and (C).

5 IRC § 6673(a)(1).

6 The standards for the IRS's decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual (CCDM). *See* CCDM 35.10.2 (Aug. 11, 2004). For sanctions of opposing parties, under IRC § 6673(a)(2), all requests for sanctions are reviewed by the designated agency sanctions officer (currently the Associate Chief Counsel (Procedure & Administration)). This review ensures uniformity on a national basis. *See*, e.g., CCDM 35.10.2.2.3 (Aug. 11, 2004).

7 *"Sua sponte"* means without prompting or suggestion; on its own motion. Black's Law Dictionary (9th ed. 2009). Thus, for conduct that it finds particularly offensive, the Tax Court can choose to impose a penalty under IRC § 6673 even if the IRS has not requested the penalty. *See, e.g., Barry v. Comm'r*, T.C. Memo. 2011-127.

8 IRC § 7433(a) allows a taxpayer a civil cause of action against the United States if an IRS employee intentionally or recklessly, or by reason of negligence, disregards any IRC provision or Treasury regulation in connection with collecting the taxpayer's federal tax liability.

9 IRC § 6673(b)(1).

10 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court's decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer's position in the appeal was frivolous or groundless.

§§ 1912 and 1927 of Title 28 of the U.S. Code,[11] and Rule 38 of the Federal Rules of Appellate Procedure[12] (among other laws and rules of procedure) authorize federal courts to impose penalties against taxpayers or their representatives for raising frivolous arguments or using litigation tactics primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in nontax cases, this report focuses primarily on the IRC § 6673 penalty.

ANALYSIS OF LITIGATED CASES

We analyzed 38 opinions issued between June 1, 2011, and May 31, 2012, that addressed the IRC § 6673 penalty. Twenty-four of these opinions were issued by the Tax Court and 14 were issued by U.S. Courts of Appeals in cases brought by taxpayers who sought review of the Tax Court's imposition of the penalty. Notably, the Courts of Appeals sustained the Tax Court's position in all 14 cases.

In nine cases, the Tax Court imposed penalties under IRC § 6673, with the amounts ranging from $1,000 to the maximum of $25,000. In four cases, taxpayers prevailed when the IRS asked the court to impose a penalty, but in each case the court warned the taxpayers not to bring similar arguments in the future.[13] Three taxpayers were represented by attorneys or other persons admitted to practice before the Tax Court; all 35 others appeared *pro se* (represented themselves). The taxpayers in these cases presented a wide variety of arguments that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts almost invariably cited the language set forth in *Crain v. Commissioner:*

> We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system — including the role played within that system by the Internal Revenue Service and the Tax Court — has long been established.[14]

In the Tax Court cases we reviewed, taxpayers raised the following issues that the court deemed frivolous. Consequently, the taxpayers were subject to a penalty under IRC § 6673(a)(1) (or, in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future if the taxpayers maintained the same positions):

11 28 U.S.C. § 1912 provides that when the Supreme Court or a United States Court of Appeals affirms a judgment, the court has the discretion to award to the prevailing party just damages for the delay, and single or double costs. 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and vexatiously multiplying proceedings; such person may be required to personally pay the excess costs, expenses, and attorneys' fees reasonably incurred because of his or her conduct.

12 Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.

13 *See, e.g., Callihan v. Comm'r*, T.C. Memo. 2011-268, *appeal docketed*, No. 12-11586 (11th Cir. Mar. 26, 2012).

14 *Crain v. Comm'r*, 737 F.2d 1417, 1417-18 (5th Cir. 1984).

- **Citizens of certain states are not subject to income taxes:** Taxpayers in at least four cases argued that as residents of "independent" states, they are not subject to income taxes imposed by the United States government.[15] In all four cases the court warned the taxpayers that asserting similar arguments in the future could result in imposition of the § 6673 penalty. Husband and wife taxpayers in another case argued that only residents of "federal zones" or "IRS districts" were responsible for paying income taxes, and the court fined each taxpayer $20,000.[16]
- **Taxpayers who disagree with how the government allocates spending should not be required to pay income taxes:** In at least one case, the taxpayer argued that he did not approve of how the government chose to spend revenue.[17] Specifically, the taxpayer asserted that he disagreed with the wars in Afghanistan and Iraq and requiring him to pay income tax would violate the Nuremberg Principles.[18] The court raised the § 6673 penalty *sua sponte* and declined to impose the penalty, but warned the taxpayer that further similar conduct could result in the imposition of the penalty.
- **Only income earned from the United States government or entities associated with the United States government is taxable:** Taxpayers in at least two cases presented arguments that only federal government employees, public servants, those who earn income from the United States government, or those who earn income from federally licensed corporations are subject to the income tax.[19] The Tax Court imposed the § 6673 penalty in both cases.[20]

CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated year after year, which the courts routinely and universally reject.[21] Taxpayers avoided the IRC § 6673 penalty in only four cases where the IRS requested it, demonstrating the willingness of the courts to penalize taxpayers when they offer frivolous arguments or institute a case merely for delay. Where the IRS has not requested the penalty, the court may nonetheless raise the issue *sua sponte*, and in many cases imposes the penalty or cautions the taxpayer that similar future behavior will result in a penalty.[22] Finally, the U.S. Courts of Appeals have shown their willingness to uphold the penalties imposed by the Tax Court without fail in the cases analyzed for the period between June 1, 2011, and May 31, 2012.

15 *See, e.g., Callihan v. Comm'r*, T.C. Memo. 2011-268, *appeal docketed*, No. 12-11586 (11th Cir. Mar. 26, 2012) (taxpayer argued that services performed in Florida are not performed in the U.S. and therefore are not taxable); *Carlson v. Comm'r*, T.C. Memo. 2012-76, *appeal docketed*, No. 12-72030 (9th Cir. June 26, 2012) (taxpayer argued that as a resident of Washington or Oregon, she did not live in the U.S. and therefore was not subject to tax).

16 *Barry v. Comm'r*, T.C. Memo. 2011-127.

17 *Thompson v. Comm'r*, T.C. Memo. 2011-291.

18 The Nuremberg Principles were guidelines developed after the trial of certain Nazi war criminals to determine what constitutes a war crime and a crime against humanity.

19 *See Parker v. Comm'r*, T.C. Memo. 2012-66; *Barry v. Comm'r*, T.C. Memo. 2011-127.

20 *See id.*

21 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 666-669.

22 *See, e.g., D'Arcy v. Comm'r*, T.C. Memo. 2011-213 (court raised the issue *sua sponte* and warned the taxpayer not to assert similar arguments in the future).

MLI #9

Relief From Joint and Several Liability Under IRC § 6015

SUMMARY

Married couples may elect to file their federal income tax returns jointly or separately. Spouses filing joint returns are jointly and severally liable for any deficiency or tax due.[1] Joint and several liability permits the IRS to collect the entire amount due from either taxpayer.[2]

Internal Revenue Code (IRC) § 6015 provides three avenues for relief from joint and several liability. Section 6015(b) provides "traditional" relief for deficiencies. Section 6015(c) also provides relief for deficiencies for certain spouses who are divorced, separated, widowed, or not living together, by allocating the liability between the spouses. Section 6015(f) provides "equitable" relief from both deficiencies and underpayments, but only applies if a taxpayer is not eligible for relief under IRC § 6015(b) or (c).

We reviewed 39 federal court opinions involving relief under IRC § 6015 that were issued between June 1, 2011, and May 31, 2012. The most significant issues the courts addressed this year are the effect of prior proceedings on the Tax Court's jurisdiction and whether District Courts have jurisdiction to determine innocent spouse claims raised as a defense in a collection suit. The Tax Court also decided a case that illustrates some of the dynamics involved when the IRS agrees that relief is appropriate but the other spouse opposes it.

PRESENT LAW

Traditional Innocent Spouse Relief Under IRC § 6015(b)

IRC § 6015(b) provides that a requesting spouse shall be partially or fully relieved from joint and several liability, pursuant to procedures established by the Secretary, if the requesting spouse can demonstrate that:

1. A joint return was filed;
2. There was an understatement of tax attributable to erroneous items of the nonrequesting spouse;[3]
3. Upon signing the return, the requesting spouse did not know or have reason to know of the understatement;

1 IRC § 6013(d)(3). We use the terms "deficiency" and "understatement" interchangeably for purposes of this discussion and the case table in Appendix III, even though IRC § 6015(b)(1)(D) and (f) expressly use the term "deficiency" and IRC § 6015(b)(1)(B) refers to an "understatement of tax."

2 The National Taxpayer Advocate, in the 2005 Annual Report to Congress, proposed legislation that would eliminate joint and several liability for joint filers. See National Taxpayer Advocate 2005 Annual Report to Congress 407.

3 An erroneous item is any income, deduction, credit, or basis that is omitted from or incorrectly reported on the joint return. See Treas. Reg. § 1.6015-1(h)(4).

4. Taking into account all the facts and circumstances, it is inequitable to hold the requesting spouse liable; and
5. The requesting spouse elected relief within two years after the IRS began collection activities against him or her.[4]

A requesting spouse is eligible for a refund under this subsection so long as the requesting spouse made the payment and the requirements of IRC § 6511 have been met.[5]

Allocation of Liability Under IRC § 6015(c)

IRC § 6015(c) provides that the requesting spouse shall be relieved from liability for deficiencies allocable to the nonrequesting spouse, pursuant to procedures established by the Secretary. To obtain relief under this section, the requesting spouse must demonstrate that:

1. A joint return was filed;
2. At the time relief was elected, the joint filers were unmarried, legally separated, widowed, or had not lived in the same household for the 12 months immediately preceding the election; and
3. The election was made within two years after the IRS began collection activities with respect to the requesting spouse.

This election allocates to each joint filer the portion of the deficiency attributable to each filer as calculated under the allocation provisions of IRC § 6015(d). A taxpayer is ineligible to make an election under IRC § 6015(c) if the IRS demonstrates that, at the time he or she signed the return, the requesting taxpayer had "actual knowledge" of any item giving rise to the deficiency.[6] Relief is not available for amounts attributable to fraud, fraudulent schemes, or certain transfers of disqualified assets.[7] Finally, no credit or refund is allowed as a result of relief granted under IRC § 6015(c).[8]

Equitable Relief Under IRC § 6015(f)

IRC § 6015(f) provides that the Secretary may relieve a taxpayer from liability for both deficiencies and underpayments[9] where the taxpayer demonstrates that:

1. Relief under IRC § 6015(b) or (c) is unavailable; and

4 Not all actions that involve collection will trigger the two-year period of limitations. Under the regulations, only the following four events constitute "collection activity" that will start the two-year period: (1) an IRC § 6330 notice; (2) an offset of an overpayment of the requesting spouse against the joint income tax liability under IRC § 6402; (3) the filing of a suit by the United States against the requesting spouse for the collection of the joint tax liability; and (4) the filing of a claim by the United States to collect the joint tax liability in a court proceeding in which the requesting spouse is a party or which involves property of the requesting spouse. Treas. Reg. § 1.6015-5(b)(2).

5 IRC 6015(g)(1). See Footnote 17 for an explanation of the general time period for filing refund claims under IRC § 6511.

6 IRC § 6015(c)(3)(C).

7 IRC § 6015(c)(4), (d)(3)(C).

8 IRC § 6015(g)(3).

9 An underpayment of tax occurs when the tax is properly shown on the return but is not paid. *Washington v. Comm'r*, 120 T.C. 137, 158-59 (2003).

2. Taking into account all the facts and circumstances, it would be inequitable to hold the taxpayer liable for the underpayment or deficiency.

Previously, the IRS incorporated the statutory two-year deadline found in IRC § 6015 (b)(1)(E) and (c)(3)(B) into the section 6015 regulations and thereby imposed the two-year rule on requests for equitable relief under IRC § 6015(f).[10] In 2009, the Tax Court, in *Lantz v. Commissioner*, held the regulation imposing the two-year rule invalid.[11] The IRS appealed the Tax Court's *Lantz* and similar decisions, and three Courts of Appeal ultimately held that the regulation was valid.[12] In the meantime, the Tax Court continued to hold the regulation invalid, and the issue was appealed to other Courts of Appeal.[13] The National Taxpayer Advocate consistently advocated for removal of the two-year rule that prevented taxpayers from obtaining equitable relief.[14] As reported last year, on July 25, 2011, the IRS announced that, notwithstanding three appellate court decisions that upheld the validity of the regulation, the regulations issued under IRC § 6015 would be revised to remove the two-year rule for requests for equitable relief.[15] Cases in litigation would be resolved consistently with this decision; pending modification of the regulation to formally remove the two-year rule, taxpayers requesting equitable relief under IRC § 6015(f) after July 25, 2011, may do so without regard to when the first collection activity was taken. Taxpayers must file requests for equitable relief within the period of limitation on collection in IRC § 6502[16] or, for any credit or refund of tax, within the period of limitation in IRC § 6511.[17]

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10 Treas. Reg. §1.6015-5(b)(1).

11 132 T.C. 131 (2009).

12 *Lantz v. Comm'r*, 607 F.3d 479 (7th Cir. 2010) *rev'g and remanding* 132 T. C. 131 (2009); *Mannella v. Comm'r*, 631 F.3d 115 (3d Cir. 2011) *rev'g and remanding* 132 T.C. 196 (2009); *Jones v. Comm'r*, 642 F.3d 459 (4th Cir. 2011), *rev'g and remanding* T.C. Docket No. 17359-08 (May 28, 2010).

13 Adhering to the rule in *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd*. 445 F.2d 985 (10th Cir. 1971), that the Tax Court will defer to a Court of Appeals decision which is squarely on point where appeal from the Tax Court decision lies to that Court of Appeal, the Tax Court continued to hold the regulation invalid in cases appealable to other circuits. *See, e.g., Young v. Comm'r*, T.C. Docket No. 12718-09 (May 12, 2011); *Pullins v. Comm'r*, 136 T.C. 432 (2011); *Stephenson v. Comm'r*, T.C. Memo. 2011-16; *Hall v. Comm'r*, 135 T.C. 374, *appeal dismissed* (6th Cir. Aug. 2, 2011); *Buckner v. Comm'r*, T.C. Docket No. 12153-09, *appeal dismissed* (6th Cir. July 27, 2011); *Carlile v. Comm'r*, T.C. Docket No. 11567-09, appeal dismissed (9th Cir. Dec. 8, 2010); *Payne v. Comm'r*, T.C. Docket No. 10768-09, *appeal dismissed* (9th Cir. July 25, 2011); *Coulter v. Comm'r*, T.C. Docket No. 1003-09, *appeal dismissed* (2d Cir. Aug. 4, 2011).

14 National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015 (f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*); vol. 2 at 1-12 (*Unlimit Innocent Spouse Equitable Relief*); National Taxpayer Advocate 2006 Annual Report to Congress 540 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief under IRC § 6015 or 66*).

15 IR 2011-80 (July 25, 2011), *available at* http://www.irs.gov/uac/Two-Year-Limit-No-Longer-Applies-to-Many-Innocent-Spouse-Requests. Details of the changes to the rule are provided in Notice 2011-70, 2011-2 C.B. 135 (July 25, 2011), *available at* http://www.irs.gov/pub/irs-drop/n-11-70.pdf. The Notice contains transitional rules and provides that pending litigation will be managed consistently with the removal of the two-year rule. See also CC-Notice 2011-017 (July 25, 2011), providing direction for Chief Counsel attorneys handling cases docketed with the Tax Court that involve the two-year deadline.

16 The statutory period of limitations on collection is generally ten years after the date the tax is assessed. IRC § 6502(a). However, a variety of statutory provisions may extend or suspend the collection period. For example, if a court proceeding to collect the tax is brought, such as a suit to reduce a tax liability to judgment, the period of limitations on collection is extended. Therefore, the period of limitations on collection could exceed ten years and a claim for innocent spouse relief would be valid at any point during that time.

17 Generally, taxpayers must request a refund within three years from the date their return was filed, or two years from the time the tax was paid, whichever occurs later, or, if no return was filed, within two years from the time the tax was paid. IRC § 6511(a). If taxpayers meet the three-year requirement, they can recover payments made during the three-year period that precedes the date of the refund request, plus the period of any extension of time for filing the return. However, taxpayers who do not meet the three-year requirement can recover only payments made during the two-year period preceding the date of the refund request. IRC § 6511(b)(2).

Revenue Procedure 2003-61 lists some of the factors the IRS has considered in determining whether equitable relief is appropriate.[18] In January 2012, the IRS issued a proposed revenue procedure to supersede Rev. Proc. 2003-61.[19] IRS Chief Counsel attorneys immediately applied the provisions of the proposed revenue procedure in docketed Tax Court cases, as did the court.[20] However, taxpayers were advised to notify the IRS in their applications for relief (or supplement existing applications) if they would receive more favorable treatment under one or more of the factors provided in Revenue Procedure 2003-61. The IRS would then apply those factors until the proposed new revenue procedure was finalized.

Factors common to both the old and new guidance include marital status, economic hardship, knowledge or reason to know, legal obligations of the nonrequesting spouse, significant benefit to the requesting spouse, and compliance with income tax laws. Abuse was an additional factor under Revenue Procedure 2003-61; the proposed guidance removed abuse as a separate factor, but clarified the effect abuse has on the analysis generally and on the knowledge factor and significant benefit factors specifically.[21]

Rights of Nonrequesting Spouse

The individual with whom the requesting spouse filed the joint return is generally referred to as a "nonrequesting spouse," and is granted certain rights by IRC § 6015. The nonrequesting spouse must be notified and given an opportunity to participate in any administrative proceedings concerning a claim under IRC § 6015.[22] Further, if during the administrative process full or partial relief is granted to the requesting spouse, the nonrequesting spouse can file a protest and receive an administrative conference in the IRS Appeals function.[23] The nonrequesting spouse does not have the right to petition the Tax Court in response to the IRS's administrative determination regarding IRC § 6015 relief.[24] If the requesting spouse files a Tax Court petition, the nonrequesting spouse must receive notice of the Tax Court proceeding and has an unconditional right to intervene in the proceeding to dispute or support the requesting spouse's claim for relief.[25] However, an intervening spouse has no standing to appeal the Tax Court's decision to the United States Court of Appeals.[26]

18 Rev. Proc. 2003-61, 2003-2 C.B. 296.

19 Notice 2012-8 (Jan. 5, 2012), 2012-4 I.R.B. 309, *available at* http://www.irs.gov/irb/2012-04_IRB/ar09.html. The Department of Treasury and the IRS invited public comment on the proposed guidance and on the administration of the IRS's innocent spouse program by Feb. 21, 2012.

20 CC-Notice 2012-004 (Jan. 5, 2012), *available at* http://www.irs.gov/pub/irs-ccdm/cc-2012-004.pdf. See *Sriram v. Comm'r*, T.C. Memo. 2012-91, in which the Tax Court analyzed the claim under the provisions of Rev. Proc. 2003-61 and Notice 2012-8.

21 Notice 2012-8, §§ 4.01(5), (7)(d); 4.02(3); 4.03(2)(c)(iv), (e).

22 IRC § 6015(h)(2).

23 Rev. Proc. 2003-19, 2003-5 C.B. 371.

24 *Maier v. Comm'r*, 119 T.C. 267 (2002), *aff'd*, 360 F.3d 361 (2d Cir. 2004) (holding that no provisions in IRC § 6015 allow the nonrequesting spouse to petition the Tax Court from a notice of determination).

25 *Van Arsdalen v. Comm'r*, 123 T.C. 135 (2004).

26 *Baranowicz v. Comm'r*, 432 F.3d 972 (9th Cir. 2005).

Judicial Review

Taxpayers seeking relief under IRC § 6015 generally file Form 8857, *Request for Innocent Spouse Relief*.[27] After reviewing the request, the IRS issues a final notice of determination granting or denying relief in whole or in part. The taxpayer has 90 days from the date the IRS mails the notice to file a petition with the Tax Court.[28] The Tax Relief and Health Care Act of 2006 amended IRC § 6015(e) to expressly provide that the Tax Court has jurisdiction in stand-alone cases to review IRC § 6015(f) determinations, even where no deficiency has been asserted.[29]

ANALYSIS OF LITIGATED CASES

We analyzed 39 opinions issued between June 1, 2011, and May 31, 2012, including 32 Tax Court opinions, one each from the United States Courts of Appeals for the Third, Fourth, and Ninth Circuits, one from the Court of Federal Claims, and three from U.S. District Courts. In one Tax Court opinion, both spouses sought relief and the court consolidated their cases for trial, briefing, and opinion.[30] Because that opinion considered each spouse's claim separately, the total number of cases we analyze is 40. Fifty-three percent of the cases (21 of 40) were decided in favor of the IRS (including one case in which only the intervenor opposed granting relief);[31] 28 percent (11 of 40) in favor of the requesting spouse (including four cases in which only the intervenor opposed granting relief); and 20 percent (eight of 40) ended in split decisions. In 45 percent (18 of 40) of the cases, the taxpayers were *pro se* (*i.e.*, they represented themselves). Taxpayers prevailed in 17 percent (three of 18) of the cases in which they proceeded *pro se*; four other *pro se* taxpayers obtained split decisions. The nonrequesting spouse intervened in 38 percent of the cases (15 of 40).

Eighty-three percent of the cases (33 of 40) involved an analysis of whether to grant relief. Thirty percent of the cases (12 of 40) involved procedural issues,[32] with 83 percent (ten of 12) of these cases decided in favor of the IRS, and 17 percent (two of 12) in favor of the taxpayer.

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27 *See* IRS Form 8857, *Request for Innocent Spouse Relief* (Sept. 2010).

28 IRC § 6015(e)(1)(A)(ii). In 2001, IRC § 6015(e) provided for Tax Court review of deteminations under IRC 6015(b) or (c), and it was not clear that taxpayers seeking relief only under IRC § 6015(f) could obtain Tax Court review. The National Taxpayer Advocate recommended amending IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court for review of determinations made only under IRC § 6015(f). *See* National Taxpayer Advocate 2001 Annual Report to Congress 159-65 (Key Legislative Recommendation: *Joint and Several Liability Final Determination Rights*). The statute was so clarified in 2006. *See* Pub. L. 109-432, Title IV, § 408(a).

29 Pub. L. No. 109-432, Div. C, § 408(a), (c), 120 Stat. 2922, 3061-62 (2006). The filing of a Tax Court petition in response to the final notice of determination or after the IRC § 6015 claim is pending for six months is often referred to as a "stand-alone" proceeding, because jurisdiction is predicated on IRC § 6015(e) and not deficiency jurisdiction under IRC § 6213.

30 *Gaitan v. Comm'r*, T.C. Memo 2012-3.

31 These percentages add up to more than 100 due to rounding. In *Nunez v. Comm'r*, T.C. Memo. 2012-121, the IRS at trial conceded, taking the position that the requesting spouse was entitled to relief. Only the intervenor opposed granting relief. The Tax Court did not accept the government's concession and agreed with the intervenor, holding that relief was not appropriate. Although the Tax Court did not follow the position taken by the IRS, because the Tax Court's decision allows the IRS to collect the full liability as a result of the decision, it is counted as having been decided in favor of the IRS.

32 The percentages add up to more than 100 and the number of cases adds up to more than 40 because five cases addressed procedural issues and also contained an analysis of whether to grant relief on the merits.

Of the 33 cases decided on the merits, 45 percent (15 of 33) were decided in favor of the IRS, 30 percent (ten of 33) in favor of the taxpayer, and in 24 percent (eight cases) the court split its decision. See Table 9 in Appendix III for a detailed breakdown of the cases.

Procedural Issues

Three Tax Court cases addressed the effect of prior proceedings on the court's jurisdiction. In two of the cases, the taxpayer was prevented by the doctrine of *res judicata* from requesting innocent spouse relief.[33] In one case, the taxpayer was permitted to raise the issue even though he could have requested relief in a prior deficiency proceeding.[34] Additionally, two district courts continued the disturbing trend of holding that a taxpayer was not entitled to raise innocent spouse relief as a defense in a collection suit.[35]

Harbin v. Commissioner, Koprowski v. Commissioner, and Beach v. Commissioner

In *Harbin v. Commissioner*,[36] Mr. and Mrs. Harbin petitioned the Tax Court for review of the IRS's determination of tax deficiencies with respect to joint returns they filed for two years. The deficiencies arose in part from Mrs. Harbin's disallowed gambling losses. Mr. Harbin prepared the returns based on documents and gambling records Mrs. Harbin provided, but was unaware of her actual losses and the understatements of tax attributable to her gambling when he signed the returns. It appeared that Mrs. Harbin maintained different records than those she provided Mr. Harbin, which she produced to the IRS during the examination of the returns. Consequently, Mr. Harbin had a viable claim for innocent spouse relief under IRC § 6015(b). His interest in the deficiency case was adverse to Mrs. Harbin's interest in contesting the deficiencies because to qualify for relief under IRC § 6015(b), Mr. Harbin would have to prove the deficiencies were attributable to Mrs. Harbin's erroneous items.[37]

In their deficiency case, Mr. and Mrs. Harbin were represented by the same attorney. For the attorney, under the circumstances this was a conflict of interest,[38] which he evidently did not recognize and did not disclose to the Harbins.[39] The same attorney also represented

33 *Koprowski v. Comm'r*, 138 T.C. 54 (2012); *Beach v. Comm'r*, T.C. Memo. 2011-218.

34 *Harbin v. Comm'r*, 137 T.C. 93 (2011) *appeal dismissed* (7th Cir. June 6, 2012).

35 *United States v. LeBeau*, 109 A.F.T.R.2d (RIA) 1369 (S.D.Cal. 2012); *United States v. Miles*, 109 A.F.T.R.2d (RIA) 1602 (N.D.Cal. 2012).

36 137 T.C. 93 (2011) *appeal dismissed* (7th Cir. June 6, 2012).

37 *Harbin v. Comm'r*, 137 T.C. 93 n. 2.

38 Rule 1.7 of the American Bar Association (ABA) Model Rules of Professional Conduct, *Conflict Of Interest: Current Clients*, *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_7_conflict_of_interest_current_clients.html, provides: "(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client." Paragraph (b) of Rule 1.7, which sets forth the conditions under which the representation may be permissible, includes the requirement that "each affected client gives informed consent, confirmed in writing." Rule 24(g), Tax Court Rules of Practice and Procedure, *Conflict of Interest*, provides: "If any counsel of record... (2) represents more than one person with differing interests with respect to any issue in a case... then such counsel must either secure the informed consent of the client...; withdraw from the case; or take whatever other steps are necessary to obviate a conflict of interest or other violation of the ABA Model Rules of Professional Conduct, and particularly Rules 1.7, 1.8, and 3.7 thereof."

39 *Harbin v. Comm'r*, 137 T.C. 93, 96. It appears that the attorney first became aware of his conflict of interest in the deficiency case when informed by IRS Counsel in the course of the innocent spouse case.

both Mr. and Mrs. Harbin in their divorce proceeding, which was finalized shortly before trial in the deficiency case. The deficiency case was settled without trial and without either party requesting innocent spouse relief, and the Tax Court's decision reflecting the stipulated settlement became final.

When the IRS applied Mr. Harbin's overpayment of tax from a later tax year to the liability from one of the years at issue in the prior deficiency proceeding, Mr. Harbin requested innocent spouse relief, which the IRS denied. Mr. Harbin petitioned the Tax Court for review of that determination, and the former Mrs. Harbin intervened in the case. The IRS contended that Mr. Harbin's innocent spouse claim was barred by *res judicata*, which prevents relitigation of a taxpayer's liability for a given tax year both as to matters actually litigated in the prior suit and those that could have been raised.[40] IRC § 6015(g)(2) provides, however, that a final court decision in a prior proceeding will not be conclusive with respect to the qualification of a taxpayer as an innocent spouse, if that was not at issue in the prior proceeding and the court determines the taxpayer did not meaningfully participate in the prior proceeding. Whether a taxpayer "participated meaningfully" in the prior litigation depends on the facts and circumstances; there is no statutory or judicial definition of the term.[41]

Innocent spouse relief was not at issue in the prior deficiency proceeding, so the court examined Mr. Harbin's participation in the prior proceeding to determine whether *res judicata* barred his claim. Considering that Mrs. Harbin's gambling activities gave rise to the deficiency, that only she had personal knowledge of her winnings and losses, and that she maintained and provided the gambling records, the court found Mrs. Harbin effectively had exclusive control over the prior deficiency case. Mr. Harbin's participation in that case was through the attorney who proceeded in spite of a conflict of interest, which limited his ability to represent Mr. Harbin and obstructed Mr. Harbin's opportunity to request innocent spouse relief.[42] Mr. Harbin was never advised of the possibility of requesting innocent spouse relief in the prior proceeding. Based on the facts and circumstances, the court found Mr. Harbin had not participated meaningfully in the deficiency proceeding and therefore his claim for relief was not barred by the doctrine of *res judicata*.

The parties had stipulated that if Mr. Harbin's claim was not barred, he met several of the requirements for relief under IRC § 6015(b): that a joint return was filed, that the understatement was attributable to the erroneous items of the other joint filer, and that

40 As the Supreme Court, in *Comm'r v. Sunnen*, 333 U.S. 591, 597-98, (1948), explained, the doctrine of *res judicata* "rests upon considerations of economy of judicial time and public policy favoring the establishment of certainty in legal relations. The rule provides that when a court of competent jurisdiction has entered a final judgment on the merits of a cause of action, the parties to the suit and their privies are thereafter bound 'not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.' *Cromwell v. County of Sac*, 94 U.S. 351, 352, 24 L.Ed. 195." Moreover, "[i]ncome taxes are levied on an annual basis. Each year is the origin of a new liability and of a separate cause of action. Thus if a claim of liability or non-liability relating to a particular tax year is litigated, a judgment on the merits is *res judicata* as to any subsequent proceeding involving the same claim and the same tax year."

41 *Harbin v. Comm'r*, 137 T.C. 93, 98.

42 *Id. at* 99.

the request for relief was timely. The court needed only to address the issue of whether Mr. Harbin knew or should have known of the understatement, and whether, taking into account all the facts and circumstances, it would be inequitable to hold him liable for the deficiencies. The court found it compelling that Mrs. Harbin apparently showed records to the IRS that she had not shown to Mr. Harbin, and found he was entitled to relief under IRC § 6015(b).

Koprowski v. Commissioner

In *Koprowski v. Commissioner*,[43] the IRS determined a deficiency in tax with respect to Mr. and Mr. Koprowski's joint 2006 return. The Koprowskis petitioned the Tax Court for review of the determination, and elected to proceed under the small tax case procedures provided by IRC § 7463.[44] Both Mr. and Mrs. Koprowski signed the petition and three subsequent court filings. One of the filings stated that Mr. Koprowski was seeking innocent spouse relief and had already requested it from the IRS. When the Koprowskis' case was called from the calendar for trial, both Mr. and Mrs. Koprowski were present, and Mr. Koprowski spoke for the couple in scheduling further proceedings. Later that day, the Koprowskis, who had not been represented by counsel, were assisted by volunteer counsel and ultimately conceded their case in full without further proceedings. The Tax Court entered its decision sustaining the deficiencies in November 2009.

In May 2010, the IRS denied Mr. Koprowski's request for innocent spouse relief, and he petitioned the Tax Court for review of that determination. The IRS argued that Mr. Koprowski's claim was barred by the doctrine of *res judicata*. The court agreed, noting that *res judicata* attaches to judgments rendered in small tax cases conducted pursuant to IRC § 7463.[45] In considering whether the IRC § 6015(g)(2) exception to the doctrine of *res judicata* applied, the court found that innocent spouse relief had been placed in issue in the prior proceeding by one of the Koprowskis' court filings and that Mr. Koprowski meaningfully participated in the prior proceeding. The claim was therefore barred, even though the issue was not actually litigated. The court affirmed the IRS's denial of Mr. Koprowski's innocent spouse claim.

Beach v. Commissioner

In *Beach v. Commissioner*,[46] Mr. Beach petitioned the Tax Court for review of an asserted deficiency arising from the joint 2004 tax return he filed with his spouse, who was not a

43 138 T.C. 54 (2012).

44 IRC § 7463(a) provides that in deficiency cases where the amount in controversy is $50,000 or less for any one taxable year, taxpayers may opt to proceed in accordance with Tax Court rules for small tax cases. Title XVII of the Tax Court's Rules of Practice & Procedure set forth rules applicable in small tax cases. Generally, proceedings in small tax cases are less formal and entail a more relaxed approach to admitting evidence than in regular tax cases. However, decisions in small tax cases are not subject to appeal.

45 The court explicitly left open the question of whether the related doctrine of collateral estoppel would likewise attach to judgments in small tax cases. A concurring opinion expressed the view that it would. *Koprowski v. Comm'r*, 138 T.C. 54, 66-67 (Holmes, J., concurring).

46 T.C. Memo. 2011-218.

party to the deficiency case.[47] Mr. Beach agreed with the IRS's Appeals Officer to settle the case, and the Tax Court entered its decision in August 2008 based on the parties' stipulation. Mr. Beach did not request innocent spouse relief in that proceeding, but Mrs. Beach did and the IRS granted it.[48] Mr. Beach then also requested innocent spouse relief, which the IRS denied, and Mr. Beach petitioned the Tax Court for review of that determination. The IRS contended that Mr. Beach's claim was barred by *res judicata*, and the court agreed, noting that it would be "difficult for us to fathom what participating meaningfully would mean [for purposes of IRC § 6015(g)(2)] if petitioner did not do it in the prior proceeding."[49] Mr. Beach, as the sole party to the deficiency case, exercised exclusive control over it. He alone met with the Appeals Officer, negotiated the settlement, and signed the decision document. The doctrine of *res judicata* barred him from raising the innocent spouse claim he could have raised in the prior proceeding.

United States v. LeBeau and United States v. Miles

The *Le Beau* and *Miles* cases[50] continued the disturbing trend, identified by the National Taxpayer Advocate in past Annual Reports to Congress, of restricting a taxpayer's ability to raise IRC § 6015 as a defense in district court proceedings.[51] IRC § 6015 (e)(1)(A) provides that an individual who seeks relief from joint liability may, "in addition to any other remedy provided by law," petition the Tax Court to determine the appropriate relief available. Other statutory provisions and judicial precedent make clear that taxpayers may raise IRC § 6015 in a variety of contexts.[52] This year, one district court, in *U.S. v. Melot*, considered the defense in a suit to reduce joint federal tax assessments to judgment and to foreclose federal tax liens.[53] However, in the *LeBeau* and *Miles* cases, two California district courts, relying on *United States v. Boynton*, held that they do not have jurisdiction over IRC § 6015

47 Mr. Beach's deficiency case, like the Koprowskis', was designated as a small tax case, but Mr. Beach did not argue that the doctrine of *res judicata* does not apply in small tax cases. T.C. Memo. 2011-218.

48 The deficiency at issue arose from disputed expenses and losses claimed with respect to rental properties that were Mr. Beach's separate properties. T.C. Memo. 2011-218.

49 T.C. Memo. 2011-218, slip. op at 6.

50 *United States v. LeBeau*, 109 A.F.T.R.2d (RIA) 1369 (S.D.Cal. 2012); *United States v. Miles*, 109 A.F.T.R.2d (RIA) 1602 (N.D.Cal. 2012).

51 *See* National Taxpayer Advocate 2010 Annual Report to Congress 504; National Taxpayer Advocate 2009 Annual Report to Congress 487; National Taxpayer Advocate 2008 Annual Report to Congress 524; National Taxpayer Advocate 2007 Annual Report to Congress 631. Moreover, the National Taxpayer Advocate three times recommended that legislation clarify that taxpayers may raise relief under IRC §§ 6015 and 66 as a defense in collection actions. *See* National Taxpayer Advocate 2010 Annual Report to Congress 377; National Taxpayer Advocate 2009 Annual Report to Congress 378; National Taxpayer Advocate 2007 Annual Report to Congress 549.

52 *See* IRC §§ 6320(c) and 6330(c)(2)(A)(i) (pertaining to collection due process proceedings); IRC § 6213 and *Corson v. Comm'r*, 114 T.C. 354, 363 (2000) (pertaining to deficiency proceedings); 11 U.S.C.A.§ 505(a) (pertaining to bankruptcy proceedings); and IRC § 7422 (pertaining to refund suits).

53 *United States v. Melot*, 109 A.F.T.R.2d (RIA) 1568 (D.N.M. 2012), *appeal dismissed*, (10th Cir. Aug. 1, 2012) (holding that relief under IRC § 6015 was not available because the taxpayer requesting relief had not filed a joint return, and that relief under IRC § 66 was not available because the taxpayer did not establish that she did not know, and had no reason to know, of the item of community income giving rise to the unpaid tax).

claims raised as a defense in an action to reduce joint federal tax assessments to judgment or in a foreclosure suit.[54]

In *LeBeau*, Mrs. LeBeau was denied innocent spouse relief by the IRS[55] and did not petition the Tax Court for review. When Mrs. LeBeau sought to raise innocent spouse as a defense in a suit to reduce joint tax liabilities to judgment, the court, citing *Boynton*, held, "[t]he district court has jurisdiction to decide an innocent spouse issue only when the taxpayer files a refund suit in the district court while a § 6015 petition is pending with the Tax Court.... Otherwise, the district court has no jurisdiction to decide an innocent spouse claim."[56] Mrs. LeBeau was not permitted to raise her innocent spouse claim as a defense.

In *Miles*, Mrs. Miles sought innocent spouse relief for the first time as a defense in a suit to reduce joint tax liabilities to judgment and to foreclose federal tax liens.[57] The court also relied on *Boynton* for the proposition that "the district court has no jurisdiction to consider the innocent spouse defense when the taxpayer has not first sought such relief with the IRS."[58]

Relief on the Merits

While the courts considered many factors in determining the appropriateness of relief on the merits under IRC § 6015, the most significant factor was whether the requesting taxpayer had actual or constructive knowledge that there was a deficiency or that the nonrequesting spouse would not pay the tax. All three avenues for relief contain a knowledge element or factor, making it the linchpin in most of the courts' analyses.[59] Actual or constructive knowledge was a factor in 28 of the 33 cases decided on the merits. These cases suggest that determining what a taxpayer knew or should have known will continue to generate a significant amount of controversy as long as joint filers are taxed on their combined incomes and remain jointly and severally liable for the tax that must be shown on the return.

In five decisions, the IRS agreed relief would be appropriate for at least one of the years at issue and only the intervening spouse opposed relief. In one such case, the Tax Court

54 *United States v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007) (holding that the district court has no jurisdiction to consider the innocent spouse defense when the taxpayer has not first sought such relief with the IRS, reasoning that otherwise a district court and the Tax Court would have concurrent jurisdiction over the claim and might be placed in the position of adjudicating the same issues at the same time). District courts in other jurisdictions have also not permitted the defense. *See United States v. Wallace*, 105 A.F.T.R.2d 2827 (S.D. Ohio 2010), *adopted by* 105 A.F.T.R.2d (RIA) 2831 (S.D. Ohio 2010) (relying on *Boynton*); *United States v. Bucy*, 100 A.F.T.R.2d (RIA) 6666 (S.D. W. Va. 2007); *United States v. Feda*, 97 A.F.T.R.2d (RIA) 1985, 1989 (N.D. Ill. 2006) (taxpayer could not raise IRC § 6015 as a defense in a suit to reduce joint federal tax assessments to judgment); *United States v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006), *appeal dismissed* (3d Cir. July 5, 2007) (taxpayer could not raise IRC § 6015 as a defense in a suit to foreclose tax liens).

55 *United States v. LeBeau*, 109 A.F.T.R.2d (RIA) 1369 (S.D.Cal. 2012).

56 *Id.*, slip op. at 7-8.

57 *United States v. Miles*, 109 A.F.T.R.2d (RIA) 1602 (N.D.Cal. 2012).

58 *Id.*, slip op. at 7.

59 *See* IRC § 6015(b)(1)(C); § 6015(c)(3)(C); Rev. Proc. 2003-61, 2003-2 C.B. 296 §§ 4.02(1)(b) and 4.03(2)(a)(iii); Notice 2012-8, §§ 4.02(3) and 4.03(2)(c), 2012-4 I.R.B. 309.

granted relief and decided the taxpayer could not recover from the IRS the portion of litigation costs that arose after the IRS conceded relief was appropriate.[60]

In *Pounds v. Commissioner*, Mrs. Pounds and her former spouse, Mr. Johnson, filed a joint return for 2004.[61] After they were audited, they consented to the assessment of deficiencies that arose from omitted income and disallowed deductions from Mr. Johnson's business. Mrs. Pounds then requested innocent spouse relief, which the IRS denied. Mrs. Pounds petitioned the Tax Court for review, unaware that the IRS had reversed its position and had issued a revised determination granting innocent spouse relief under IRC § 6015(c). If Mrs. Pounds had known the IRS had changed its mind, she would have had no need to petition the Tax Court. After she filed the petition, if Mrs. Pounds and the IRS had been the only parties to the case, the matter could have been resolved without further proceedings. However, Mr. Johnson, upon being notified of the Tax Court proceeding, exercised his right to intervene as a party to the case, claiming Mrs. Pounds was not entitled to relief under IRC § 6015(c) because she had actual knowledge, at the time she signed the return at issue, of the items giving rise to the deficiency.

The Tax Court noted a difficulty in cases where only the intervening spouse opposes granting relief and actual knowledge is at issue. The IRS, which under IRC § 6015(c) would normally bear the burden of showing that a requesting spouse knew of an item giving rise to a deficiency, may favor granting relief and may therefore no longer be adverse to the requesting spouse. Rather than shifting the burden of proof to the intervening spouse, the court has resolved this difficulty "by determining whether actual knowledge has been established by a preponderance of the evidence as presented by all three parties."[62] The IRS introduced no evidence at trial other than the stipulated facts. Mrs. Pounds and Mr. Johnson both testified, and Mr. Johnson introduced documentary evidence in support of his position. The Tax Court held that Mrs. Pounds did not have actual knowledge of the understatement and granted relief under IRC § 6015(c). In its order and decision, the Tax Court further decided that pursuant to IRC § 7430 Mrs. Pounds was entitled to recover $12,779 from the IRS, representing her administrative costs and part of her litigation costs.[63] However, the litigation costs incurred after the initial stages of the proceeding, attributable to Mr. Johnson's participation in the case, were not allocable to the IRS and were not recoverable under IRC § 7430.

60 The requesting spouse does not always obtain relief when only the intervenor is opposed. In one case, *Nunez v. Comm'r*, T.C. Memo. 2012-121, the Tax Court accepted the intervenor's position and denied relief even though the IRS argued that relief would be appropriate.

61 *Pounds v. Comm'r*, T.C. Memo. 2011-202.

62 *Pounds v. Comm'r*, T.C. Memo. 2011-202, slip op. at 13, *citing Knight v. Comm'r*, T.C. Memo. 2010-242, *McDaniel v. Comm'r*, T.C. Memo. 2009-137, and *Stergios v. Comm'r*, T.C. Memo. 2009-15.

63 Order and Decision in Tax Court docket no. 30363-09 (May 9, 2012). IRC § 7430 provides for the award of reasonable costs for an administrative or court proceeding under certain circumstances when the taxpayer is the prevailing party. Any such costs must be allocable to the United States and not to any other party. IRC § 7430(b)(2). As the court explained in an earlier order (Apr. 5, 2012), the IRS conceded the award of Mrs. Pounds' administrative costs. As for litigation costs, because Mrs. Pounds initiated the court proceeding in response to a notice of determination the IRS then renounced, she could recover litigation costs she incurred in connection with the initial pleadings in the case. The fact that the case progressed beyond that point, however, was due to Mr. Johnson's intervention (rather than to the repudiated IRS notice).

CONCLUSION

This year, in cases decided on the merits, the IRS fully prevailed less than half the time. In order to avoid imposing unnecessary burden on taxpayers, the IRS must analyze the reasons for this outcome and determine what training would help avert it. With respect to procedural developments, the Tax Court applied the *res judicata* provisions of IRC § 6015(g)(2) in three cases. The court held that *res judicata* attaches to judgments in small Tax Court cases, but a taxpayer may be prevented from meaningfully participating in a proceeding by counsel's conflict of interest. The Tax Court also decided a case in which only the intervening spouse opposed granting relief, and held that the requesting spouse who obtained relief could not recover from the IRS that portion of her litigation costs attributable to the former spouse's participation in the suit. Two District Courts continued the disturbing trend of holding that a taxpayer may not raise innocent spouse as a defense in collection suits, a development the National Taxpayer Advocate has sought to rectify since 2007.[64]

64 *See* National Taxpayer Advocate 2010 Annual Report to Congress 377; National Taxpayer Advocate 2009 Annual Report to Congress 378; National Taxpayer Advocate 2007 Annual Report to Congress 549.

MLI #10

Limitations On Assessment Under IRC § 6501

SUMMARY

The general statutory period of limitations on assessment of tax, governed by Internal Revenue Code (IRC) § 6501(a), is three years. This limitations period does not apply in certain circumstances, such as when a taxpayer files a false or fraudulent return,[1] willfully attempts to defeat or evade tax,[2] or fails to file a return altogether.[3] In these cases, the IRS may assess the tax or begin a proceeding in court for collection of such tax at any time.[4] In addition, IRC § 6501(e)(1)(A) extends the period for assessment from three to six years in cases where the taxpayer omits from gross income an amount that is properly includible and is more than 25 percent of the gross income stated in the return.

This is the first year that limitations on assessment has been analyzed as a Most Litigated Issue in the National Taxpayer Advocate's Annual Report to Congress. We reviewed 33 federal court opinions issued between June 1, 2011 and May 31, 2012 involving limitations on assessment. The most significant case was the Supreme Court's decision in *United States v. Home Concrete & Supply, LLC*.[5] This decision resolved a split among circuits and held that an understatement of income due to an overstatement of basis is not an "omission" from income and does not extend the limitations period under IRC § 6501(e)(1)(A).

PRESENT LAW

IRC § 6501(a) provides the general rule that the IRS must assess any tax within three years after a taxpayer files a return. If the return is filed early, the assessment period generally begins to run on the date the return was due.[6] If a taxpayer fails to file a return and the IRS prepares a substitute for return (SFR),[7] the limitations period does not start and the IRS can assess the tax at any time.[8]

1 IRC § 6501(c)(1).

2 IRC § 6501(c)(2).

3 IRC § 6501(c)(3).

4 IRC § 6501(c).

5 132 S. Ct. 1836 (2012).

6 IRC § 6501(b)(1). Note that for tax imposed by chapter 3 (Withholding of Tax on Nonresident Aliens and Foreign Corporations), chapter 21 (Federal Insurance Contributions Act), or chapter 24 (Collection of Income Tax at Source on Wages), if the return for any period is filed before April 15 of the succeeding calendar year, the return is considered filed on April 15. IRC § 6501(b)(2); Treas. Reg. § 301.6501(b)-1(b).

7 *See* IRC § 6020.

8 IRC § 6501(b)(3).

Section 6501(c) provides many other exceptions to the general three-year limitation on assessment. The IRS can assess the tax or begin a court proceeding to collect it at any time in the case of a taxpayer who has:

- Filed a false or fraudulent return with the intent to evade tax;[9]
- Willfully attempted in any manner to defeat or evade tax;[10] or
- Failed to file a return.[11]

IRC § 6501(c)(4) permits an extension of the limitation on assessment if both the IRS and the taxpayer agree to it, in writing, before the time for assessment has expired. Multiple extensions are permitted, so long as they are agreed to in writing before the expiration of any previous extension.[12] The taxpayer also has the right to refuse an extension, or to limit the extension to particular issues or a particular period.[13]

Another significant exception to the three-year limitation on the assessment period is provided in § 6501(e). If a taxpayer omits from gross income a properly includible amount in excess of 25 percent of the gross income stated in the return, the assessment period is extended to six years.

The general three-year rule in IRC § 6501(a) contains numerous other exceptions, but taxpayers litigated these exceptions less frequently during the period of our review. Therefore, we have focused our analysis on some of the most common issues affecting the statutory limitations period.

The bar of the statutory limitations period is an affirmative defense. A taxpayer raising the limitations period as a defense must specifically plead it and prove it.[14] In the case of an alleged false or fraudulent return, however, the burden is on the IRS to prove the taxpayer filed with an intent to evade tax.[15]

ANALYSIS OF LITIGATED CASES

We analyzed 33 opinions issued between June 1, 2011 and May 31, 2012 that addressed the IRC § 6501 limitations period. The IRS prevailed in full in 19 cases (58 percent), the taxpayers prevailed in full in 11 cases (33 percent), and three cases (nine percent) resulted in split decisions. Table 10 in Appendix III provides a detailed list of these cases.

9 IRC § 6501(c)(1).
10 IRC § 6501(c)(2).
11 IRC § 6501(c)(3).
12 IRC § 6501(c)(4)(A).
13 IRC § 6501(c)(4)(B).
14 Tax Court Rule 142(a)(1).
15 IRC § 7454(a); Tax Court Rule 142(b).

Taxpayers appeared *pro se* (without representation) in nine of the 33 cases (27 percent) and convinced the court to find in their favor in only one case. Represented taxpayers fared much better, prevailing either partially or in full in 13 of their 24 cases (54 percent).

Substantial Omission of Income

United States v. Home Concrete & Supply, LLC

The most significant development this past year with regard to IRC § 6501 was the Supreme Court decision in *Home Concrete*.[16] Previously, U.S. Courts of Appeals were split on whether an overstatement of basis can result in an "omission of income," triggering the extended IRC § 6501(e) six-year assessment period instead of the usual three year period.[17] The Supreme Court's 5-4 plurality decision in *Home Concrete* resolved this uncertainty.

In *Home Concrete*, the taxpayers understated their gross incomes for the year at issue by more than 25 percent because they had overstated their bases in certain property they sold. The IRS assessed a deficiency more than three years but less than six years after the relevant tax returns were filed. After making a deposit, the taxpayers then sued for a refund, claiming the IRS was time-barred from making the assessments under IRC § 6501(a), but the government asserted in response that IRC § 6501(e) was applicable.

The district court found that "where a taxpayer overstates basis and, as a result, leaves an amount out of gross income, the taxpayer 'omits from gross income an amount properly includible therein' for purposes of § 6501(e)(1)(A)."[18] Thus, the court concluded the government was entitled to apply the extended six-year limitations period. The taxpayers appealed, and while the case was on appeal, the Treasury Department issued regulations interpreting § 6501(e)(1)(A) in its favor, so an overstatement of basis could trigger the extended limitations period.[19] On appeal, the Fourth Circuit held that Home Concrete's overstated basis in the sale proceeds did not trigger the six-year limitations period.[20] The government then appealed, and the Supreme Court granted certiorari.[21]

The government argued before the Supreme Court that the Treasury Regulation[22] interpreting the statute's language in its favor should be granted deference under the *Chevron* stan-

16 132 S. Ct. 1836 (2012).

17 *Compare R & J Partners v. Comm'r*, 441 Fed. Appx. 271 (5th Cir. 2011) and *Bakersfield Energy Partners, LP v. Comm'r*, 568 F.3d 767 (9th Cir. 2009) (both holding that an understatement of income due to an overstatement of basis did not qualify as an "omission from gross income," and therefore did not trigger the extended limitations period), with *Intermountain Ins. Serv. of Vail, LLC v. Comm'r*, 650 F.3d 691 (D.C. Cir. 2011) (holding that an understatement of income due to an overstatement of basis was an "omission from gross income," extending the statutory period of limitations on assessment to six years), and *Salman Ranch, Ltd. v. Comm'r*, 647 F.3d 929 (10th Cir. 2011) (holding the same), and *Grapevine Imps., Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011) (holding the same), and *Beard v. Comm'r*, 633 F.3d 616 (7th Cir. 2011) (holding the same).

18 *Home Concrete & Supply, LLC v. United States*, 599 F.Supp.2d 678, 687 (E.D. N.C. 2008).

19 *See* 74 Fed. Reg. 49321 (Sept. 28, 2009) for temporary regulations, and 74 Fed. Reg. 49354 (Sept. 28, 2009) for the notice of proposed rulemaking. Treas. Reg. § 301.6501(e)-1(a)(1)(iii) became effective Dec. 14, 2010 (*i.e.*, the regulation was not applicable to the tax year at issue in *Home Concrete*).

20 *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (4th Cir. 2011).

21 *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 71 (2011).

22 Treas. Reg. § 301.6501(e)-1(a)(1)(iii).

dard.[23] The Supreme Court disagreed, determining that the Court had already interpreted a prior, but "materially indistinguishable"[24] version of the statute in its 1958 case, *The Colony, Inc. v. Commissioner*[25] and therefore the language was not ambiguous. The Supreme Court concluded that no other permissible construction of § 6501(e)(1)(A) could be adopted by the Treasury Department.

In analyzing *Colony*, the Court in *Home Concrete* acknowledged that an overstatement of basis "wrongly understates the taxpayer's income."[26] In *Colony,* the Court observed that the definition of the word "omit" is "[t]o leave out or unmentioned; not to insert, include or name."[27] Taken literally, this language limits the statute's scope "to situations in which specific receipts or accruals of income items are *left out* of the computation of gross income."[28] The *Colony* decision acknowledged that the statute was ambiguous, examined its legislative history, and concluded that Congress intended to extend the limitations period only when a taxpayer failed to report income, not when the taxpayer made an error in reporting an item disclosed on the face of the return.[29] *Colony* explained that Congress intended "no broader purpose than to give the Commissioner" extra time to investigate tax returns where, due to an omission, "the Commissioner is at a special disadvantage" because the return itself gives no indication of an omitted item.[30] But when an overstatement of basis results in the understatement of income, the error is "disclosed on the face of the return [and] the Commissioner is at no such disadvantage."[31]

In finding that *Colony* was dispositive of the issue, the Supreme Court in *Home Concrete* concluded as follows: "The provision before us is a 1954 reenactment of the 1939 provision that *Colony* interpreted. The operative language is identical. It would be difficult, perhaps impossible, to give the same language here a different interpretation without effectively overruling *Colony*." Because *Colony* eliminated any ambiguity in the statute, the *Chevron* standard did not apply.[32]

The ruling in *Home Concrete* resolved this much-litigated limitations period issue. On April 30, 2012, the Supreme Court issued a series of orders in pending § 6501(e) cases. In cases where a United States Court of Appeals found for the taxpayer, the Supreme Court simply denied certiorari, upholding the lower courts' decisions.[33] In cases where a Court of

23 *See Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984) (agency regulations are entitled to deference unless (1) they contradict an unambiguous statute, or (2) set forth an unreasonable construction of it).

24 *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836, 1840 (2012).

25 357 U.S. 28 (1958) (construing § 275(c) of the 1939 Code, a nearly identical provision).

26 *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836, 1840 (2012).

27 *Colony*, 357 U.S. at 32 (quoting Webster's New International Dictionary (2d ed. 1939)).

28 *Id*. at 33.

29 *Id*. at 35 (citing S. Rep. No. 73-558, 73d Cong., 2d Sess. 43-44 (1934)).

30 *Id*. at 36.

31 *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836, 1841 (2012).

32 *Id*. at 1842-43 (2012).

33 *See, e.g., Comm'r v. Equip. Holding Co.*, 132 S. Ct. 2122 (2012); *Comm'r v. R & J Partners*, 132 S. Ct. 2100 (2012).

Appeals found for the government, the Supreme Court granted the petitions for certiorari and immediately vacated and remanded the cases for reconsideration.[34]

Fraudulent Returns and Willful Attempts to Evade Tax

Another commonly litigated issue under IRC § 6501 was whether the taxpayer filed a false or fraudulent return, or willfully attempted to defeat or evade taxes, such that the assessment period was open indefinitely.[35] In order to assess tax at any time under § 6501(c)(1) or (2), the government must show "by clear and convincing evidence: (1) [a]n underpayment of tax exists" and (2) the taxpayer "intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes."[36] Fraud is not defined in the IRC or Treasury Regulations. Over the years, however, courts have established certain "badges of fraud"—a nonexclusive list of factors that suggest fraudulent intent.[37] The IRS has incorporated those "badges of fraud" into the Internal Revenue Manual (IRM).[38] While no single factor is dispositive, a combination of factors is likely to provide sufficient evidence of fraud, taking into account the taxpayer's "intelligence, education, and tax expertise."[39]

For example, in *Scott v. Commissioner*, the Tax Court concluded that the government had successfully established fraud, relying on the following factors: a pattern of consistent underreporting of income; maintenance of inadequate books; failure to cooperate with tax authorities; the taxpayer's lack of credibility; and the taxpayer's intelligence, education, and understanding that filing inaccurate returns would frustrate the IRS's ability to collect the correct tax.[40]

Of the nine cases that addressed the filing of alleged fraudulent returns, the Tax Court found in favor of the taxpayer in only two.[41] In these cases, although the government was able to show fraudulent activity, it was not able to show by clear and convincing evidence that the activity was intended to evade tax. For example, in *City Wide Transit,*

34 *See, e.g., Beard v. Comm'r*, 633 F.3d 616 (7th Cir. 2011), *vacated and remanded by* 132 S. Ct. 2099 (Apr. 30, 2012); *Grapevine Imps., Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011), *vacated and remanded by* 132 S. Ct. 2099 (2012).

35 IRC § 6501(c)(1)-(2). Paragraph (2) applies only to taxes other than income, estate, or gift taxes.

36 *May v. Comm'r*, 137 T.C. 147, 151 (2011), *appeal docketed* No. 12-1829 (6th Cir. June 25, 2012); *see also City Wide Transit, Inc. v. Comm'r*, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2d Cir. Mar. 14, 2012) ("Although the Court has not expounded on what constitutes a willful attempt to defeat or evade tax under section 6501(c)(2),... there is little 'meaningful distinction between [a] 'false or fraudulent return with the intent to evade tax' and [a] willful attempt in any manner to defeat or evade tax.'" (quoting *Carl v. Comm'r*, T.C. Memo. 1981-202)).

37 *See Spies v. United States*, 317 U.S. 492 (1943). *See also Scott v. Comm'r*, T.C. Memo. 2012-65 (citation omitted). Badges of fraud include: (1) understating income, (2) maintaining inadequate records, (3) failing to file tax returns, (4) implausible or inconsistent explanations of behavior, (5) concealment of income or assets, (6) failing to cooperate with tax authorities, (7) engaging in illegal activities, (8) an intent to mislead which may be inferred from a pattern of conduct, (9) lack of credibility of the taxpayer's testimony, (10) filing false documents, and (11) dealing in cash. *Id*.

38 *See* IRM 25.1.2.3 (Jan. 1, 2003).

39 *Browning v. Comm'r*, T.C. Memo. 2011-261 (citations omitted).

40 *Scott*, T.C. Memo. 2012-65.

41 *See Avenell v. Comm'r*, T.C. Memo. 2012-32; *City Wide Transit, Inc. v. Comm'r*, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2d Cir. Mar. 14, 2012).

Inc. v. Commissioner,[42] while the record clearly showed that the taxpayer's accountant filed false tax forms on behalf of the taxpayer and altered the taxpayer's checks to the IRS, the taxpayer argued there was no intent to evade tax but instead an attempt to cover up an embezzlement scheme.[43] The Tax Court agreed and found the government failed to show "by clear and convincing evidence that [the accountant] filed fraudulent returns *with the intent to evade tax* or *willfully attempted to defeat or evade tax*."[44] Therefore, the statutory limitations period was not extended and the IRS was time-barred from assessing any tax.[45]

Failure to File

If a taxpayer fails to file a return, § 6501(c)(3) allows assessment of the tax at any time. Under § 6501(a), assessment shall occur "within 3 years after the return was filed," (whether or not such return was filed on or after the date prescribed),[46] so when no return is filed, the limitations period never begins to run and the IRS can assess tax at any time.[47] However, when a taxpayer files what he or she thinks is a valid return but which contains some defect that makes it invalid,[48] the IRS treats the return as not being filed at all, thus extending the limitations period indefinitely.

In *Paschall v. Commissioner*,[49] the taxpayers (a husband and wife) timely filed Forms 1040, *U.S. Individual Income Tax Return* for all years at issue, but failed to file for any year a Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, which was required to compute and disclose excise taxes that arose from excess contributions to Roth IRAs.[50] The Tax Court rejected the taxpayers' argument that the statutory limitations period started running when they filed the Forms 1040, and the period for assessing the excise tax deficiency had expired. Relying on the Supreme Court's decision in *Commissioner v. Lane-Wells Co.*,[51] the court held that, in the absence of accompanying Forms 5329, filing the Forms 1040 did not include "sufficient information to allow the IRS to compute the taxpayer's liability," and therefore "did not start the statute of limitations running for purposes of the section 4973 excise tax."[52]

42 T.C. Memo. 2011-279.

43 *Id*.

44 *Id*. (emphasis added).

45 *Id*.

46 *See, e.g., United States v. Tyler*, 109 A.F.T.R.2d (RIA) 1383 (E.D.Pa. 2012) (holding that where taxpayer did not file returns for tax years 1992-1998 until 2000-2001, assessment in 2002 was not time-barred).

47 *United States v. Melot*, 108 A.F.T.R.2d (RIA) 6884 (D.N.M. 2011).

48 In determining what constitutes a "return" sufficient to start the running of the limitations period, most courts apply the four-part test set forth in *Beard v. Commissioner*, 82 T.C. 766, 777-78 (1984), *aff'd* per curiam, 793 F.2d 139 (6th Cir. 1986) (The document must (1) purport to be a return; (2) be signed under penalties of perjury; (3) contain sufficient data to calculate the tax liability; and (4) be completed in an honest and genuine endeavor to satisfy the requirements of the tax law.).

49 137 T.C. 8 (2011).

50 *See* IRC § 4973.

51 321 U.S. 219 (1944) (holding that a taxpayer cannot start the running of the period of limitations by filing one return when a different return is required).

52 *Paschall*, 137 T.C. at 16-17.

CONCLUSION

The general three-year limitation on assessments provided by § 6501(a) is subject to numerous exceptions. In cases where a taxpayer files a false or fraudulent return, willfully attempts to evade tax, or fails to file altogether, the statutory period of limitations never begins to run and tax may be assessed at any time. In cases involving a false or fraudulent return or a willful attempt to evade tax, the government bears the burden of proving, by clear and convincing evidence, that the taxpayer had the *explicit intent* to defeat or evade tax. The government prevailed in seven out of nine fraud cases we reviewed. In the two cases where the taxpayers prevailed, even though they engaged in fraudulent activity, the government was unable to show that evasion of tax was their primary intent.

In cases where a taxpayer omits from gross income an amount greater than 25 percent of the amount stated in the return, § 6501(e) extends the limitation on assessment from three to six years. The Supreme Court issued a significant opinion this year in *Home Concrete*. It settled a split in the U.S. Courts of Appeals, holding that an understatement of income due to an overstatement of basis was not an "omission of income" and did not trigger an extension of the statutory period of limitations on assessment.

Case Advocacy

Activities of the Office of the Taxpayer Advocate

Under Internal Revenue Code (IRC) § 7803(c), the Office of the Taxpayer Advocate has four principal functions:

- Assist taxpayers in resolving problems with the IRS;
- Identify areas in which taxpayers are experiencing problems with the IRS;
- Propose changes in the administrative practices of the IRS to mitigate problems taxpayers are experiencing with the IRS; and
- Identify potential legislative changes that may be appropriate to mitigate such problems.

Taxpayer Advocate Service (TAS) employees assist taxpayers whose tax problems are causing financial difficulty, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe an IRS system or procedure is not working as it should. While all IRS personnel must consider and protect taxpayer rights, TAS employees have a special responsibility for ensuring the IRS treats all taxpayers fairly.

In addition to helping taxpayers resolve specific cases and individual problems, TAS employees advocate for taxpayers by identifying IRS procedures that adversely affect taxpayer rights or create taxpayer burden and recommending solutions to the IRS to improve tax administration. TAS serves as the voice of the taxpayer within the IRS by providing the taxpayer's viewpoint when the IRS is considering new policies, procedures, or programs. Additionally, TAS administers the Low Income Taxpayer Clinic (LITC) grant program[1] and oversees the Taxpayer Advocacy Panel (TAP).[2]

TAS Analyzes Economic and Systemic Burden Case Receipts for Process Improvements.

Taxpayers seek TAS assistance with specific issues when:

- They have experienced a tax problem that causes financial difficulty;
- They have been unable to resolve their issues directly with the IRS; or
- An IRS action or inaction has caused or will cause them to suffer a long-term adverse impact, including a violation of taxpayer rights.

1 The LITC program provides matching grants to qualifying organizations to operate clinics that represent low income taxpayers in disputes with the IRS, or educate taxpayers for whom English is a second language about their rights and responsibilities as U.S. taxpayers. LITCs provide services to eligible taxpayers for free or for no more than a nominal fee. *See* IRC § 7526.

2 TAP is a Federal Advisory Committee established by the Department of the Treasury to provide a taxpayer perspective on improving IRS service to taxpayers. TAS provides oversight and support to the TAP program. The Federal Advisory Committee Act (5 U.S.C. Appendix) prescribes standards for establishing advisory committees when those committees will furnish advice, ideas, and opinions to the federal government. *See also* 41 C.F.R. Part 102-3.

TAS generally accepts cases in four categories:

- Economic Burden – Cases in which a taxpayer is experiencing financial difficulty;
- Systemic Burden – Cases in which an IRS process, system, or procedure has failed to operate as intended, and as a result, the IRS has failed to timely respond to or resolve a taxpayer's issue;
- Equitable Treatment or Taxpayer Rights Issues – Cases accepted to ensure taxpayers receive fair and equitable treatment and taxpayers' rights are protected; and
- Public Policy – Cases accepted when the National Taxpayer Advocate determines compelling public policy warrants assistance to an individual or group of taxpayers.[3]

In fiscal year (FY) 2012, TAS received 219,666 cases of all types, a 26 percent decrease from FY 2011, and provided relief to taxpayers in 76.9 percent of cases closed.[4] Figure 4.1 shows FY 2012 receipts and closures by case category.

FIGURE 4.1, FY 2012 TAS Case Receipts, Closures, and Relief Rates[5]

	FY 2012 Receipts	FY 2012 Closures	Relief Rate
Economic Burden	133,082	127,135	74.6%
Systemic Burden	85,671	104,412	80.1%
Equitable Treatment or Taxpayer Rights Issues	167	218	75.7%
Public Policy	746	743	29.2%
Total Cases	**219,666**	**232,508**	**76.9%**

Case receipts declined primarily for two reasons. At the start of FY 2012, TAS modified its case acceptance criteria to exclude systemic burden inquiries involving *only* the processing of original returns, amended tax returns, unpostable and rejected returns, and injured

3 TAS Interim Guidance Memorandum (IGM) TAS-13.1.7-0112-005, *Interim Guidance on Accepting Cases under TAS Case Criteria 9, Public Policy* (Jan. 9, 2012), *available at* http://www.irs.gov/file_source/pub/foia/ig/tas/tas-13-7-0112-005.pdf. Issues identified as meeting public policy criteria include: Ponzi or other failed investment scheme claims, organizations where the IRS automatically revoked their tax-exempt status because the organization did not file an annual return or notice for three consecutive years, and Earned Income Tax Credit (EITC) audits referred to TAS as part of the Correspondence Examination Enhanced Communication Study. For an in-depth discussion of the EITC study, *see EITC Communication Study, infra*.

4 TAS determines relief based upon whether TAS can provide full or partial relief or assistance on the issue initially identified by the taxpayer. Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2012). TAS uses TAMIS to record, control, and process taxpayer cases, as well as to analyze the issues that bring taxpayers to TAS.

5 Data obtained from TAMIS. TAS tracks resolution of taxpayer issues through codes entered at the time of closing on TAMIS and requires case advocates to indicate the type of relief or assistance they provide to the taxpayer. *See* Internal Revenue Manual (IRM) 13.1.21.1.2.1.2 (Feb. 1, 2011). The codes reflect full relief, partial relief, or assistance provided. The relief rate is determined by dividing the total number of cases closed with full relief, partial relief, or assistance by the total number of closures.

spouse claims.[6] These cases typically arise due to processing delays caused by seasonal spikes in IRS workload or because of systemic processing glitches. TAS's role in these cases was typically limited to asking the appropriate IRS function to resolve the problem, updating the taxpayer, and identifying systemic problems. TAS chose to no longer accept these four categories of cases to focus its limited resources on economic burden cases and on systemic burden cases where TAS plays a more direct role in advocating for relief or changing IRS policy and procedures. However, TAS will still accept cases involving the four issues described above, as follows:

- All inquiries where the taxpayer is experiencing economic burden, or the issue involves equitable treatment or taxpayer rights;
- All congressional office case referrals; and
- Systemic burden inquiries involving these four issues that also include other related issues where TAS can advocate, such as an open audit or collection action.

TAS received 76 percent fewer systemic burden case receipts for these four issues in FY 2012 than in FY 2011.[7]

TAS FY 2012 receipts also declined because of an 88 percent reduction in cases involving the First-Time Homebuyer Credit (FTHBC).[8] TAS received large volumes of cases involving FTHBC audits when this credit was available, and additional cases due to IRS problems in computing repayment of the credit when applicable. TAS received 29,777 FTHBC cases in FY 2011, but only 3,477 in FY 2012, as the IRS completed most of the audits and fixed many of the glitches involving repayment.[9] Figure 4.2 shows the number of TAS cases involving various temporary refundable credit (*e.g.,* FTHBC) and payment programs the IRS administered in recent years.

6 TAS IGM, TAS-13.1.7-0911-014, *Interim Guidance on Changes to Case-Acceptance Criteria*, (signed Sept. 1, 2011 and effective Oct. 1, 2011). Unpostable and rejected returns include those with missing information, forms, schedules, or errors that require correction prior to processing. Injured spouse claims are associated with joint returns where one spouse does not want his or her portion of the refund applied to a debt owed by the other spouse. TAS extended the changes through Sept. 24, 2013 with TAS-13-0912-019, *Reissuance of Interim Guidance on Changes to Case-Acceptance Criteria* (Sept. 25, 2012), *available at* http://www.irs.gov/pub/foia/ig/spder/TAS-13-0912-019.pdf.

7 TAS received 30,868 FY 2011 and 7,276 FY 2012 systemic burden cases where the primary issue was processing original, amended, or unpostable and reject returns, and injured spouse claims. Data obtained from TAMIS, Oct. 1, 2012 (FY 2012), Oct. 1, 2011 (FY 2011).

8 The FTHBC is a refundable tax credit that applied to qualified home purchases in 2008, 2009, and part of 2010, and included numerous eligibility rules based on adjusted gross income, age limits, home purchase price limits, and related-party rules. The $7,500 FTHBC allowed under the Housing and Economic Recovery Act of 2008 required repayment of the credit over 15 years. Pub. L. No. 110-289, § 3011, 122 Stat. 2654, 2888 (July 30, 2008). The FTHBC allowed under the American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, § 1006, 123 Stat. 115, 316 (Feb. 17, 2009)) and continued under the Worker, Homeownership, and Business Assistance Act of 2009 (Pub. L. No. 111-92, § 11, 123 Stat. 2984, 2989 (Nov. 6, 2009)), increased the credit to $8,000 and eliminated the repayment requirement.

9 Data obtained from TAMIS, Oct. 1, 2012 (FY 2012), Oct. 18, 2011 (FY 2011).

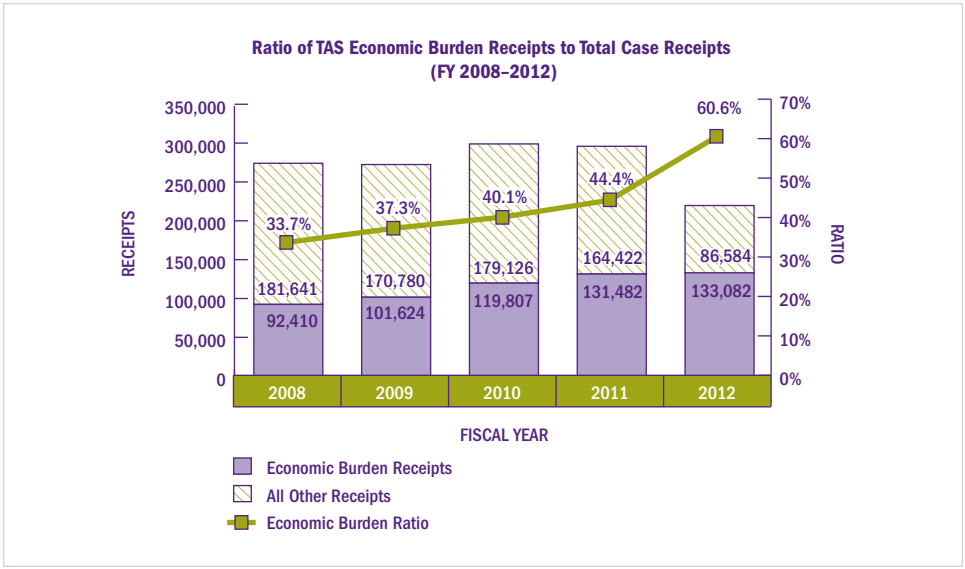
FIGURE 4.2, TAS Case Receipts Involving Temporary Refundable Credits And Payments, FY 2008–2012[10]

Program	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Economic Stimulus Payment	27,015	15,536			
First-Time Homebuyer Credit		4,622	43,520	29,777	3,477
Adoption Credit				5,572	3,770

In FY 2012, More Than Half of TAS Case Receipts Involved Economic Burden.

For the first time since TAS began its work in FY 2000, more than half of TAS case receipts involved taxpayers experiencing economic burden because of IRS issues.

FIGURE 4.3, Ratio of TAS Economic Burden Receipts to Total Case Receipts, FY 2008–2012[11]

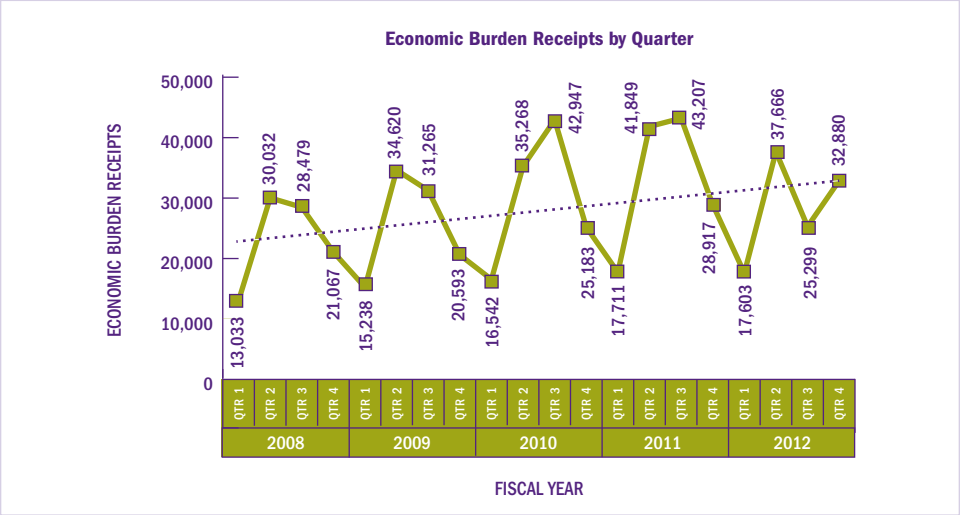


TAS received 44 percent more economic burden cases in FY 2012 than in FY 2008.

10 Data obtained from TAMIS. Economic Stimulus Payment data Oct. 7, 2010. FTHBC data Oct. 7, 2010 (FY 2009), Oct. 18, 2011 (FY 2011), Oct. 1, 2012 (FY 2012). Adoption credit data Oct. 3, 2011 (FY 2011), Oct. 5, 2012 (FY 2012).

11 Data obtained from TAMIS, Oct. 1, 2012 (FY 2012), Oct. 1, 2011 (FY 2011), Oct. 1, 2010 (FY 2010), Oct. 1, 2009 (FY 2009), Oct. 1, 2008 (FY 2008).

FIGURE 4.4, TAS Economic Burden Receipts by Quarter, FY 2008–2012[12]



TAS tracks underlying issues to identify the reasons taxpayers seek economic burden relief. Figure 4.5 lists the top five economic burden issues in FY 2012.

FIGURE 4.5, Top Five Economic Burden Case Issues, FY 2011 and FY 2012[13]

Rank	Issue Description	FY 2011	FY 2012	Percent Change
1	Stolen Identity	21,500	42,300	96.7%
2	Pre-Refund Wage Verification Hold [14]	8,616	12,649	46.8%
3	Levies (including Federal Payment Levy Program) [15]	13,299	10,174	-23.5%
4	EITC	4,928	4,915	-0.3%
5	Processing Amended Returns	5,872	4,862	-17.2%

12 Data obtained from TAMIS (FY 2012) (Oct. 1, 2012).

13 Data obtained from TAMIS, Oct. 1, 2012 (FY 2012), Oct. 1, 2011 (FY 2011). TAS computed the top five economic burden cases using only Primary Issue Codes (PIC). TAS cases often involve more than one issue and TAS tracks this data. However, these cases are not included in this computation to avoid counting a case more than once.

14 For further discussion of the National Taxpayer Advocate's concerns about pre-refund wage verification holds, *see* Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying Processing of Refunds that Trigger Systemic Filters, supra*.

15 The Federal Payment Levy Program (FPLP) is a systemic collection enforcement tool authorized by IRC § 6331(h). It allows the IRS to levy on federal payments disbursed by the Treasury's Financial Management Service (FMS) to taxpayers with an outstanding tax liability. Each week, the IRS creates a file of certain balance due accounts and transmits the file to FMS's Treasury Offset Program. FMS transmits a weekly file back to the IRS listing those that matched. FPLP will subsequently transmit levies on matching accounts.

Identity theft is the number one issue in economic burden case receipts and is currently the leading reason that taxpayers seek TAS assistance.[16] In FY 2012, economic burden identity theft receipts rose almost 97 percent compared to FY 2011. During FY 2012, about 42,000 of nearly 55,000 taxpayers (77 percent) who came to TAS with this issue experienced economic burden.[17]

Pre-refund wage verification holds are second on the list of economic burden case issues, increasing nearly 47 percent from FY 2011 to FY 2012.

Collection Issues Continue to Contribute Significantly to TAS Economic Burden Receipts.

In FY 2012, collection issues accounted for 15 percent of all economic burden receipts and just over 13 percent of TAS's total caseload. TAS provided relief for 68 percent of the taxpayers in collection cases closed.[18] In addition, in FY 2012 TAS issued 52 Taxpayer Assistance Orders (TAOs) in collection cases where the IRS did not agree with TAS's case-specific recommendations, of which the IRS complied with 44 (including three where TAS modified the TAO), TAS rescinded two, and six are still in process.[19]

As shown in Figure 4.6, while economic burden cases overall have increased 44 percent from FY 2008 to FY 2012, economic burden receipts resulting from collection issues dropped 19 percent. However, collection issues are common secondary issues in TAS cases. Eight percent of TAS FY 2012 receipts include secondary collection issues.[20]

16 For further discussion of the National Taxpayer Advocate's concerns about identity theft issues, see Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft Cases, supra.*

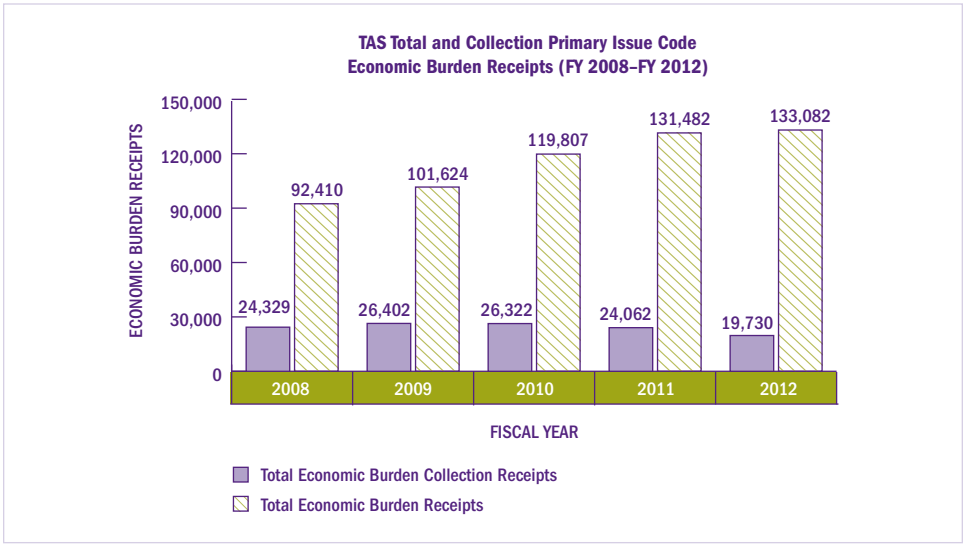
17 Data obtained from TAMIS (Oct. 1, 2011).

18 Data obtained from TAMIS (Oct. 1, 2012).

19 For a detailed discussion of TAOs, *see TAS Uses Taxpayer Assistance Orders to Advocate Effectively in Taxpayer Cases, infra*. TAO compliance data is as of Oct. 26, 2012.

20 Data obtained from TAMIS (Oct. 29, 2012).

FIGURE 4.6, TAS Total and Collection Primary Issue Code Economic Burden Receipts, FY 2008–FY 2012[21]



While collection issues are still a significant source of TAS economic burden receipts, in FY 2012 these cases have declined by 18 percent from FY 2011, from about 24,000 to just under 20,000.[22]

The National Taxpayer Advocate has repeatedly expressed concern about the adverse impact of IRS lien filing and other collection policies on taxpayers and future compliance.[23] The National Taxpayer Advocate has proposed several administrative and legislative steps to improve these policies and procedures, and to grant relief to taxpayers harmed by automatic Notice of Federal Tax Lien (NFTL) filings.[24] As discussed elsewhere in this report, partly in response to these proposals, the IRS announced a "Fresh Start" initiative in 2011 to help financially struggling taxpayers, which included several positive changes in how the

21 Data obtained from TAMIS computed using only Primary Issue Codes, Oct. 1, 2008 (FY 2008), Oct. 1, 2009 (FY 2009), Oct. 1, 2010 (FY 2010), Oct. 1, 2011 (FY 2011), and Oct. 1, 2012 (FY 2012).

22 Data obtained from TAMIS, Oct. 1, 2010 (FY 2010) and Oct. 1, 2011 (FY 2011).

23 See Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine if Its Lien-Filing Policies Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue, supra*, Most Serious Problem Introduction: *Taxpayer Service Within Collection, supra*, Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives in Order to More Effectively Resolve Collection Workload, supra*, and Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance, supra. See also* National Taxpayer Advocate FY 2012 Objectives Report to Congress 12-13; National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18, and National Taxpayer Advocate 2009 Annual Report to Congress 357-364.

24 See Taxpayer Advocate Directive (TAD) 2010-1, *Immediately discontinue automatic lien filing on Currently Not Collectible (CNC) hardship accounts with an unpaid balance of $5,000 of more, require employees to make meaningful notice of federal tax lien (NFTL) filing determinations, and require managerial approval for filings of an NFTL in all cases where the taxpayer has no assets* (Jan. 20, 2010); TAD 2010-2, *Withdrawal of a notice of federal tax lien (NFTL) where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released* (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, *available at* http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf.

IRS files and withdraws NFTLs.[25] Yet, problems remain in this and other collection areas. Thus, in FY 2012, the National Taxpayer Advocate helped develop and taught a course for her employees on effectively advocating in collection cases.[26]

TAS Identifies Problems and Trends That Negatively Impact Taxpayers, and Advocates to Resolve These Issues.

By analyzing the underlying issues in individual casework, TAS identifies trends that affect larger groups of taxpayers and uses that information to work with the IRS to resolve the broader issues.[27] Figure 4.7 lists the top 15 issues facing taxpayers.

FIGURE 4.7, Top 15 Issues Received In TAS in FY 2012[28]

Rank	Issue Description	FY 2011	FY 2012	Percent Change
1	Stolen Identity	34,006	54,748	61.0%
2	Pre-Refund Wage Verification Hold	21,286	18,012	-15.4%
3	Levies (Including Federal Payment Levy Program)	15,466	11,419	-26.2%
4	Reconsideration of Audits[29] and Substitute for Return under IRC § 6020(b)[30]	11,902	9,344	-21.5%
5	Open Audit (Not Earned Income Tax Credit)	21,397	8,885	-58.5%
6	Processing Amended Returns	22,743	8,783	-61.4%
7	Earned Income Tax Credit	8,729	7,441	-14.8%
8	Processing Original Returns	11,578	6,250	-46.0%
9	Expedite Refund Request	9,386	5,726	-39.0%
10	IRS Offset	6,995	5,298	-22.0%
11	Unpostable and Rejected Returns	13,288	5,286	-60.2%
12	Installment Agreements	5,899	4,449	-24.6%
13	Injured Spouse Claim	8,295	4,115	-50.4%
14	Reconsideration of Automated Underreporter	5,151	3,696	-28.2%
15	Other Refund Inquiries/Issues	6,135	3,572	-41.8%
Total TAS Receipts		**295,904**	**219,666**	**-25.8%**

25 IRS Announcement IR-2011-20, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process* (Feb. 24, 2011) *available at* http://www.irs.gov/uac/IRS-Announces-New-Effort-to-Help-Struggling-Taxpayers-Get-a-Fresh-Start;-Major-Changes-Made-to-Lien-Process.

26 Course 50517, *Roadmap to a Tax Controversy Level Two – Collections* (Aug. 2012).

27 TAS uses a variety of sources to identify systemic problems, including TAS employees, other IRS employees, tax practitioners, members of Congress, LITCs, TAP, and the public. These stakeholders submit systemic issues to TAS through a variety of channels, including the Systemic Advocacy Management System (SAMS) on the IRS employee intranet and the TAS site on IRS.gov (http://www.irs.gov/uac/Taxpayer-Advocate-Service-6).

28 Data obtained from TAMIS, Oct. 1, 2011 (FY 2011), Oct. 1, 2012 (FY 2012). TAS computed the top 15 issues using only Primary Issue Codes. Often TAS cases involve more than one issue and TAS tracks this data, however these are not included within this computation to avoid counting a case more than once. Data reflect only the top 15 issues, not all TAS receipts for the FY.

29 The IRS uses audit reconsideration to reevaluate the results of a prior audit where additional tax was assessed and remains unpaid, or a tax credit was reversed. IRM 4.13.1.2 (Oct. 1, 2006).

30 IRC § 6020(b) allows the IRS to prepare a return on behalf of the taxpayer based on available information, and assess the tax after providing a statutory notice deficiency to the taxpayer.

The most significant trend is the connection between the top two issues. Refund-related identity theft and attempts to claim false wage withholding or credits have a common theme: the perpetrators are abusing the tax system to receive improper refunds.[31] Another common thread in both areas is tax preparer refund fraud, in which unscrupulous preparers alter taxpayers' returns by inflating income, deductions, credits, or withholding without their clients' knowledge or consent, and take the increased refunds for themselves. Discussion of each of these issues appears below.

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

Tax-related identity theft (IDT) continues to present challenges to the IRS.[32] News outlets report organized groups are engaged in tax-related IDT, including "classes" where perpetrators teach others how to file tax returns with stolen identities.[33] The National Taxpayer Advocate testified five times before Congress in 2012 on IRS challenges in dealing with identity theft perpetrators and victims, and has discussed IDT issues in numerous Reports to Congress.[34]

In June 2010, W&I's Identity Protection Specialized Unit (IPSU) began working non-economic burden IDT cases.[35] The IPSU is a centralized IRS organization within Accounts Management that assists taxpayers that are, or may become, victims of IDT. In FY 2012,

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31 Employment-related identity theft also exists, but the IRS has procedures in place to minimize the harm to the victim in those cases. In employment-related identity theft, the individual files a tax return (typically using an Individual Taxpayer Identification Number (ITIN) assigned by the IRS), but uses another individual's Social Security number (SSN) to work, and the employer reports the wages to the IRS under the SSN.

32 For a more detailed discussion of identity theft issues and the National Taxpayer Advocate's concerns about IRS implementation of this program, see Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft, supra.*

33 Tampa Bay Times, *49 Accused of Tax Fraud and Identity Theft*, (Sept. 2, 2011), *available at* http://www.tampabay.com/news/publicsafety/crime/40-accused-of-tax-fraud-and-identity-theft/1189406; Tampa Bay Online, *Police: Tampa Street Criminals Steal Millions Filing Fraudulent Tax Returns*, (Sept. 1, 2011), *available at* http://www2.tbo.com/news/politics/2011/sep/01/11/police-tampa-street-criminals-steal-millions-filin-ar-254724/.

34 *Identity Theft-Related Tax Fraud, Hearing Before H. Subcomm. On Government Organization, Efficiency, and Financial Management, Comm. On Oversight and Government Reform*, 112th Congress (statement of Nina E. Olson, National Taxpayer Advocate) (Nov. 29, 2012); *Identity Theft and Income Tax Preparation Fraud, Hearing Before H. Subcomm. on Crime, Terrorism, and Homeland Security, Comm. On the Judiciary*, 112th Congress (statement of Nina E. Olson, National Taxpayer Advocate) (June 28, 2012); *Identity Theft and Tax Fraud, Hearing Before H. Subcomm. On Oversight and Social Security, Comm. On Ways and Means*, 112th Congress (statement of Nina E. Olson, National Taxpayer Advocate) (May 8, 2012); *Tax Compliance and Tax-Fraud Prevention, Hearing Before H. Subcomm. On Government Organization, Efficiency, and Financial Management, Comm. On Oversight and Government Reform*, 112th Congress (statement of Nina Olson, National Taxpayer Advocate) (Apr. 19, 2012); and *Tax Fraud by Identity Theft, Part 2: Status, Progress, and Potential Solutions, Hearing Before S. Subcomm. On Fiscal Responsibility and Economic Growth, Comm. On Finance*, 112th Congress (statement of Nina E. Olson, National Taxpayer Advocate) (Mar. 20, 2012). *See also* National Taxpayer Advocate 2005 Annual Report to Congress 180-191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2008 Annual Report to Congress 79-94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2009 Annual Report to Congress 307-317 (Status Update: *IRS's Identity Theft Procedures Require Fine Tuning*); National Taxpayer Advocate FY 2012 Objectives Report to Congress 14-18 (Areas of Focus: *The IRS Needs to Improve Its Identity Theft Victim Assistance Strategy*); and National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*).

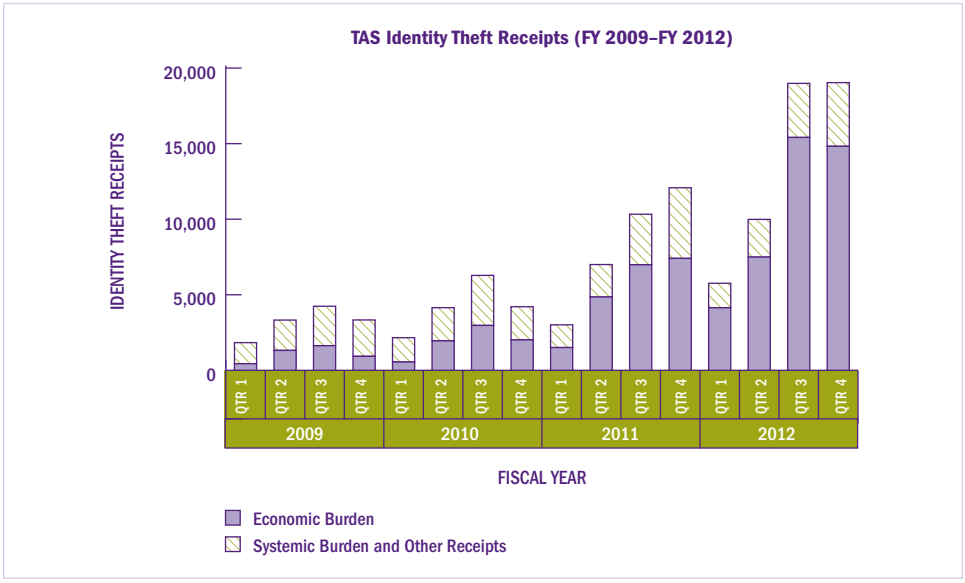
35 Memorandum of Understanding Between the National Taxpayer Advocate and the Commissioner, *W&I to Transition TAS Criteria 5-7 Identity Theft Cases to W&I IPSU* (Mar. 31, 2010).

IPSU receipts totaled nearly 450,000.[36] Taxpayers reported almost 155,000 tax-related identify theft incidents to the IRS in the first nine months of calendar year 2012.[37] The IRS internally identified over 920,000 additional identity theft incidents in the first nine months of calendar year 2012.[38]

In 2010, TAS and IPSU entered into a Memorandum of Understanding to transition some systemic burden TAS IDT cases to the IPSU.[39] In FY 2010, the IPSU handled nearly 3,400 cases that TAS would otherwise have received. In FY 2011, this number increased to nearly 26,700, and in FY 2012 it was over 44,000.[40]

Despite IPSU taking on some systemic burden IDT cases, identity theft still ranked as the number one reason taxpayers came to TAS in FY 2012. TAS IDT receipts continued to increase substantially in FY 2012, as reflected in Figure 4.8 below.

FIGURE 4.8, TAS Identity Theft Receipts, FY 2009–FY 2012, Economic And Systemic Burden[41]



36 IRS, *IPSU Paper Inventory Report* (Sept. 29, 2012).

37 IRS, *Identity Protection Incident Tracking Statistics Report* (Jan. 1, 2012 – Sept. 29, 2012).

38 *Id*.

39 Memorandum of Understanding Between the National Taxpayer Advocate and the Commissioner, *W&I to Transition TAS Criteria 5-7 Identity Theft Cases to W&I IPSU* (Mar. 31, 2010). The following are examples of when TAS would continue to advocate for identity theft victims: (1) the taxpayer declines referral to the IPSU; (2) the IPSU has already tried to provide relief in the past, and has failed; (3) systemic burden cases that require advocacy which might lead to the issuance of a TAO on behalf of the taxpayer; (4) taxpayer cases added to TAMIS will remain in TAS and be resolved through the Operations Assistance Request (OAR) process; (5) taxpayers not satisfied with the assistance provided through the IPSU; (6) taxpayers being assisted by the IPSU, who subsequently face economic burden while the IPSU is processing their request, will come to TAS for assistance, when the IPSU cannot provide relief within 24 hours; (7) congressional cases; and (8) any cases previously open in TAS. *Available at*: http://www.irs.gov/pub/irs-utl/wi_tas_ipsu_mou_signed_03-31-2010.pdf. *See also* IRM 13.1.16.9.7 (June 22, 2012).

40 IRS, *IPSU Identity Theft Report* (Oct. 1, 2011); IRS, *IPSU Identity Theft Report* (Sept. 29, 2012).

41 Data obtained from TAMIS. TAS captured the data on the first day of the month following the end of each quarter for FY 2008 through FY 2012.

TAS continues to search for ways to improve the IRS's ability to assist victims of identity theft and participates on numerous servicewide identity theft teams to address identity theft challenges. Such challenges include:

- Keeping pace with a growing, increasingly complex caseload;
- Implementing consistent identity theft procedures across multiple IRS organizations; and
- Improving taxpayer service and identity theft case processing efficiency while managing the complex case resolution process.

The Questionable Refund Program Remains a Top Issue in TAS Case Receipts.

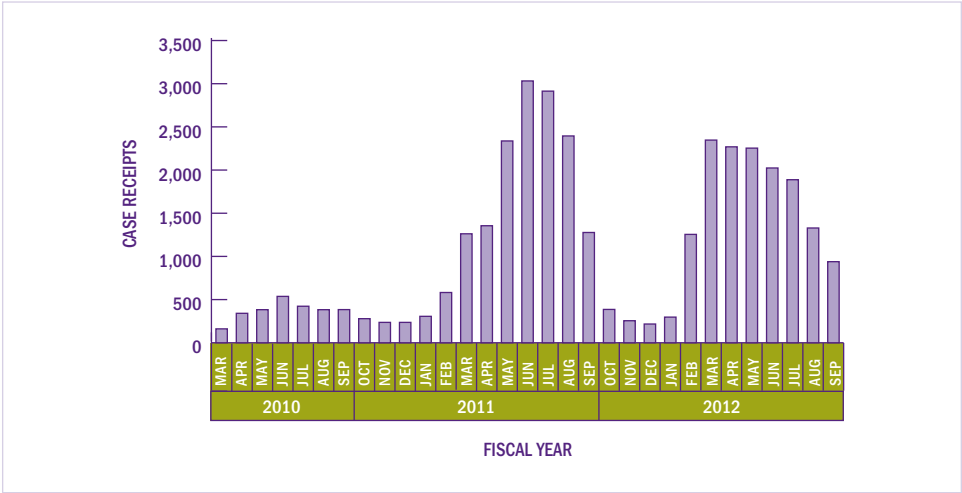
The Questionable Refund Program (QRP) has resurfaced in the past two years as a top issue in TAS casework in the form of Pre-Refund Wage Verification Hold (PRWVH) receipts.[42] In FY 2012, TAS received 18,012 PRWVH cases, providing some form of relief in 70 percent of cases closed.[43] Figure 4.9 shows the monthly increase in these cases once the civil side of this work shifted from the Criminal Investigation Division to W&I.[44]

42 *See* Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers By Unreasonably Delaying Processing of Refunds That Trigger Systemic Filters, supra*; National Taxpayer Advocate 2007 Annual Report to Congress 448-458 (Status Update: *Questionable Refund Program*); National Taxpayer Advocate 2006 Annual Report to Congress 408-421 (Status Update: *Major Improvements in the Questionable Refund Program and Some Continuing Concerns*); National Taxpayer Advocate 2005 Annual Report to Congress 25-54 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2003 Annual Report to Congress 175-181 (Most Serious Problem: *Criminal Investigation Freezes*).

43 Data obtained from TAMIS. TAS determines relief based upon whether TAS is able to provide full or partial relief or assistance on the issue initially identified by the taxpayer.

44 W&I began working the civil side of the QRP on October 11, 2009. TAS began tracking its W&I QRP cases in March 2010.

FIGURE 4.9, TAS Monthly Pre-Refund Wage Verification Hold Receipts, March 2010 Through September 2012[45]



The IRS administers the civil side of the QRP through the office of Refund Integrity and Correspondence Services (RICS). RICS includes the Accounts Management Taxpayer Assurance Program (AMTAP) to review returns with questionable wages and withholding and a Taxpayer Protection Unit (TPU) that reviews tax returns the IRS suspects claim questionable credits or were filed by identity thieves.[46] To accomplish its primary goal of revenue protection, the IRS selects questionable returns using the Electronic Fraud Detection System (EFDS) before releasing refunds and screens them electronically to verify the accuracy of the taxpayers' wages, withholding, and taxpayer identity. For returns with wage and withholding issues, if this initial review cannot confirm the amounts, AMTAP employees begin a manual verification process that can take up to 11 weeks or more, and can create financial hardship for taxpayers who are awaiting legitimate refunds.[47]

The IRS schedules an automatic release of the hold placed on the taxpayer's refund when the review period expires. However, if the IRS cannot verify the accuracy of the return in this time due to workload backlogs, it places a "hard freeze" on the account that does not expire automatically. AMTAP cases with this hard freeze may become a low priority for resolution as AMTAP focuses on cases that have a looming automatic release date. This

45 Data obtained from TAMIS. TAS captures data on the first day following the end of each month, *i.e.*, Oct. 1, 2011 for September 2011; for March 2010 through September 2012. TAS computed the receipts included in this table using the primary issue for the case. Often TAS cases involve more than one issue and TAS tracks this data, however these are not included within this computation to avoid counting a case more than once.

46 *See* IRM 21.9.1.13 (May 25, 2012).

47 The manual verification process for wages and withholding includes contacting the taxpayer's employer, or if directed by the employer, the payroll processing firm, to verify wages and withholding. AMTAP employees will also perform research to ensure they have the employer's current address. *See* IRM 21.9.1.2 (May 4, 2012).

causes the hard freeze cases to sit unworked for months, which leads more taxpayers to TAS for help.[48]

For returns that the IRS suspects were filed by identity thieves, the TPU sends a letter requesting taxpayer contact to verify identity. If the taxpayer does not pass the verification process, TPU employees void the tax return. The TPU also sends letters to certain taxpayers who filed returns with questionable refundable credits. If those taxpayers fail the verification process, another component of RICS (Automated Questionable Credits or AQC) sends a proposed disallowance letter.[49]

While the IRS has improved its ability to detect and prevent refund fraud, its fraud filters inevitably catch some taxpayers eligible for legitimate refunds, and IRS procedures currently impose unacceptable burden on these legitimate taxpayers.[50] TAS has issued 48 TAOs to RICS during FY 2012 to help taxpayers receive legitimate refunds, of which the IRS complied with 44.[51]

IRS Procedural Gaps Make it Difficult to Assist Taxpayers Victimized by Return Preparer Fraud.

TAS identified an increasing number of taxpayers defrauded by tax return preparers, who sometimes alter returns without taxpayers' consent or knowledge to obtain an inflated refund.[52] One example of how a return preparer could commit refund fraud follows:

- The preparer gives a copy of the legitimate tax return to the taxpayer;
- Without the taxpayer's knowledge or consent, the preparer alters the return to inflate or add withholding, credits, and deductions, resulting in a higher refund;
- The preparer files the altered return with the IRS; and
- The preparer directs the IRS to split the refund between two bank accounts, with the correct refund going to the taxpayer and the fraudulent portion going to the preparer.

Since the taxpayer receives the refund expected, often the taxpayer has no reason to suspect fraud. The taxpayer only learns of the fraud when the IRS tries to recover the fraudulent refund or the taxpayer requests a transcript of the account to apply for a loan or

48 For an example of how "questionable" refunds can languish in a "hard freeze" state for months and even years, see National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*) and National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*). See also National Taxpayer Advocate 2006 Annual Report to Congress 408 (Status Update: *Major Improvements in the Questionable Refund Program and Some Continuing Concerns*). TAS conducted a research study that found that 80 percent of taxpayers in a statistically representative sample of TAS QRP cases had received at least a partial refund (66 percent had received a full refund) and that taxpayers had to wait about nine months, on average, to receive these refunds.

49 *See* IRM 21.9.1.13.3 (May 25, 2012).

50 For a full discussion of IRS procedures and the taxpayer burden they create, see Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying Processing of Refunds That Trigger Systemic Filters*, *supra*.

51 Data obtained from TAMIS. TAO compliance is as of Oct. 26, 2012. For a detailed discussion of TAOs, see *TAS Uses Taxpayer Assistance Orders to Advocate Effectively in Taxpayer Cases*, *infra*.

52 TAS received 385 return preparer fraud cases in FY 2012. Data obtained from TAMIS (Oct. 29, 2012).

student financial aid and discovers the discrepancy between the tax return received from the preparer and IRS records.[53]

The National Taxpayer Advocate issued guidance to TAS employees to help them identify preparer refund fraud and advocate for taxpayers.[54] However, in spite of a 2003 Chief Counsel opinion that provides the IRS a roadmap for correcting accounts, the IRS failed to timely issue procedures to its employees to reverse the harm done to taxpayers.[55] On May 23, 2012, the National Taxpayer Advocate issued additional guidance to TAS employees, temporarily suspending normal case processing procedures for return preparer fraud cases.[56] Ordinarily, TAS would issue an Operations Assistance Request (OAR) and allow time for the IRS to respond to the OAR before elevating disagreements or inaction to the Local Taxpayer Advocate (LTA) for consideration of a TAO. In return preparer fraud cases, Case Advocates immediately elevate the case so LTAs can issue a TAO without first issuing an OAR.

In FY 2012, TAS issued 58 TAOs related to preparer refund fraud, of which 53 percent have been appealed to the National Taxpayer Advocate.[57] TAS issued the majority of these TAOs to assist taxpayers whose preparers stole their refunds by changing information on the return (without the taxpayer's knowledge) and misappropriating the refund. When a fraudulent return is filed by someone other than the taxpayer, the taxpayer's account is corrupted by the false information. The IRS should remove the fraudulent information as it does in identity theft cases; however, to date the IRS has refused to do so. The IRS continues to stand by its position that because it paid out the refund according to the instructions it received, it is not required to remove the fraudulent information from the victim's account or issue a replacement refund. The IRS's position is that the taxpayer's sole recourse is to pursue the matter in a civil lawsuit against the return preparer.

In addition to advocating case by case for individual taxpayers, on January 12, 2012, the National Taxpayer Advocate issued a Taxpayer Advocate Directive (TAD) to the W&I and SB/SE Commissioners, ordering the IRS to issue guidance to correct all victims' accounts. After the Operating Division Commissioners appealed the TAD, the National Taxpayer Advocate elevated it to the Deputy Commissioner for Services and Enforcement on March

53 For a detailed discussion of return preparer refund fraud, see Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Fully Resolve Their Accounts, supra*.

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

55 IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003), *available at* http://www.irs.gov/pub/lanoa/pmta-2011-013.pdf.

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

57 Data obtained from TAMIS. Appeal data is as of Oct. 26, 2012. Thirty-one of the 58 TAOs issued were appealed to the National Taxpayer Advocate.

16, 2012.[58] Although the IRS eventually issued interim guidance to its employees on June 26, 2012 and expanded the guidance in September 2012, it remains incomplete and leaves some affected taxpayers in limbo pending additional advice from the Office of Chief Counsel.[59]

A high-profile instance of preparer refund fraud came to light when the Illinois Attorney General's office sued the return preparation firm Mo' Money Taxes on March 14, 2012, accusing the company of filing unauthorized federal income tax returns and charging its clients undisclosed and exorbitant fees.[60] A representative from the Attorney General's office inquired if TAS could assist the alleged victims. TAS sent the Attorney General's office information about seeking TAS assistance, and informed the IRS that these taxpayers require assistance (including collection holds while their accounts were corrected). In FY 2012, TAS received and accepted 83 cases related to Mo' Money actions, providing at least some relief in 59 percent of the 71 cases closed.[61]

Delays in Processing Claims for the Adoption Credit Are Caused by Up-Front Documentation Requirements.

The Patient Protection and Affordable Care Act increased the maximum adoption credit to $13,360 for 2011, and made the credit fully refundable.[62] The eligibility rules vary for domestic, foreign, and special needs child adoptions. However, in all three categories, taxpayers claiming the credit can no longer file returns electronically because the IRS requires paper documentation with Form 8839, *Qualified Adoption Expenses*.[63]

The IRS scrutinizes these returns because the credit is large and refundable. As in audits of other refundable credits, the IRS holds the adoption credit portion of the refund until the audit determines whether the taxpayer is eligible for the credit.[64] The Treasury Inspector General for Tax Administration (TIGTA) reported that through December 23, 2011, the IRS received more than 101,000 claims for over $1.2 billion in adoption credits for tax year 2010. Of these, the IRS selected over 43,000 (43 percent) for audit because the claim had

58 TAS, TAD 2012-1, *Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund* (Jan. 12, 2012). Memorandum to the Deputy Commissioner for Services and Enforcement (Mar. 16, 2012).

59 Servicewide Electronic Research Program (SERP) Alert 12A0417, *Memphis AM ONLY – Return Preparer Misconduct Interim Guidance* (June 26, 2012), *superseded by* IRS IGM WI-21-0812-02 (Sept. 6, 2012), *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY), available at* http://www.irs.gov/pub/foia/ig/spder/WI-21-0812-02.pdf.

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

61 Data obtained from TAMIS (Oct. 30, 2012).

62 Pub. L. No. 111-148, § 10,909, 124 Stat. 119, 1021 (Mar. 23, 2010) (*amending* IRC § 23 and redesignating it as IRC § 36C. Rev. Proc. 2010-40, 2010-46 I.R.B. 663.

63 For more information and further discussion of the adoption credit, see Most Serious Problem: *The IRS's Compliance Strategy for the Expanded Adoption Credit Has Resulted in Excessive Delays to Taxpayers and Increased Costs for the IRS and Does Not Bode Well for Future Credit Administration, supra.*

64 IRM 21.5.10.4.1.2, *Examination Refund Hold Projects*, (Mar. 16, 2011).

invalid or insufficient documentation, or none at all.[65] However, when the Government Accountability Office (GAO) reviewed approximately 35,000 closed adoption credit audits, it found the IRS disallowed all or part of the credit only 17 percent of the time.[66] This means the IRS closed 83 percent of these audits without changing the taxpayers' refunds or balances owed, a far higher "no change" rate than the 14 percent for all other correspondence audits.[67] E-filing returns and electronic documentation for this credit would benefit both taxpayers and the IRS:

- IRS examiners could access documentation submitted immediately, eliminating requests for information taxpayers already submitted;
- E-filing software would alert taxpayers (or their tax preparers) of the documentation requirements, and could reject transmission of returns with none attached; and
- By reducing adoption credit returns received with no documentation, the IRS would reduce the burden and cost of an audit on taxpayers and the IRS, thus freeing up IRS compliance resources for more productive audits in other areas.

In FY 2012, TAS has received over 3,700 adoption credit cases and provided relief in 84 percent of the 4,847 cases closed.[68]

TAS Assists Taxpayers Impacted by the Closing of Tax Dispute Resolution Firms.

In March 2012, TaxMasters, Inc. filed for Chapter 11 bankruptcy protection (modified to Chapter 7 liquidation in May 2012) and a jury returned a $195 million verdict against the firm in a lawsuit filed by the Texas Attorney General.[69] TaxMasters provided tax-related representation and services to about 4,000 clients nationwide.[70] The Texas Attorney General's office and the bankruptcy trustee contacted TAS in April 2012 to see if TAS could assist TaxMasters clients. TAS took the following actions:

- The National Taxpayer Advocate sent all TaxMasters clients a letter that gave them an overview of their options, and encouraged those facing immediate adverse collection actions to contact TAS.
- The letter included an attachment explaining the collection process and collection alternatives such as installment agreements, currently not collectible status, and offers in compromise.

65 TIGTA, Ref. No. 2012-40-065, *Processes to Address Erroneous Adoption Credits Result in Increased Taxpayer Burden and Credits Allowed to Nonqualifying Individuals* 2 (June 13, 2012).

66 GAO, GAO-12-098, *Adoption Tax Credit – IRS Can Reduce Audits and Refund Delays* 10 (Oct. 20, 2011).

67 *Id*.

68 Data obtained from TAMIS (Oct. 5, 2012 and Oct 29, 2012).

69 Attorney General of Texas News Release, *Houston-Based TaxMasters and Founder Patrick Cox Ordered to Pay Over $195 Million For Defrauding Customers in Texas and Nationwide* (Mar. 30, 2012) *available at* https://www.oag.state.tx.us/oagnews/release.php?id=4020.

70 TAS, *TAS Letter to TaxMasters Clients* (July 11, 2012) *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/TaxMasters_letter.pdf.

- The letter also included a Frequently Asked Questions (FAQ) document discussing issues related to representation, including Low Income Taxpayer Clinics available to assist eligible individuals.[71]

TAS is tracking TaxMasters cases to determine what types of relief clients sought (payment plans, levy release, offer in compromise, etc.), and how often TAS could advocate for relief. In FY 2012, TAS received 24 cases and provided relief in 64 percent of the 14 cases closed.[72]

TAS Uses Taxpayer Assistance Orders to Advocate Effectively.

The TAO is a powerful tool for LTAs to use to resolve their cases. An LTA should consider issuing a TAO when the taxpayer is suffering or about to suffer a significant hardship because of the manner in which the internal revenue laws are administered, and the law and the facts support the relief.[73] The LTA may issue a TAO to order the IRS to take an action, cease an action, or refrain from taking an action;[74] for example, to release a levy.[75] The LTA may also issue a TAO to order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level.[76]

TAOs can also bring systemic problems to light and help drive systemic improvement in the IRS. For example, in FY 2012 the IRS Accounts Management (AM) division in the Atlanta Campus experienced a backlog and was unable to timely work TAS identity theft OARs. Since most TAS IDT cases involve taxpayers experiencing an economic burden, the lack of timely response was unacceptable.[77] Therefore, TAS issued 128 TAOs to AM, ordering the unit to complete the actions originally requested on the OAR.

Because of the number of TAOs issued (nearly 30 percent of all TAOs issued by TAS in FY 2012), the AM division reevaluated the way it was addressing its backlog. On July 23, 2012, AM instructed TAS and AM employees to send OARs where taxpayers are experiencing an economic burden to the Austin AM division for expedite processing.[78] Redistributing the work allowed AM to address the backlog of work in Atlanta and facilitated relief to taxpayers by providing resources to handle TAS cases requiring immediate attention.

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71 TAS, *Frequently Asked Questions for Taxmasters Clients* (July 10, 2012) *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/taxmasters_faq.pdf. LITCs are independent from the IRS. Controversy clinics serve individuals whose income is below a certain level and who need to resolve a tax problem. These clinics provide professional representation before the IRS or courts in audits, appeals, tax collection disputes, and other issues for free or for a small fee. English as a second language (ESL) clinics provide information about taxpayer rights and responsibilities in many different languages. Some clinics provide both services.

72 Data obtained from TAMIS (Oct. 30, 2012).

73 Treas. Reg. § 301.7811-1(a), 76 Fed. Reg. 18,059 (Apr. 1, 2011). *See also* IRC § 7811(a)(1).

74 IRC § 7811(b)(2).

75 IRC § 7811(b)(1).

76 Treas. Reg. § 301.7811-1(c), 76 Fed. Reg. 18,059 (Apr. 1, 2011); IRM 13.1.20.3 (Dec. 15, 2007).

77 Over 75 percent (38,747 of 51,302) of IDT OARs are from TAS economic burden cases. Data obtained from TAMIS (Oct. 1, 2012).

78 *See* IRM 21.6.2.4.2.8 (July 23, 2012).

The ability to issue a TAO ensures "that TAS can effectively resolve problems and protect taxpayer rights when the taxpayer has a significant hardship, even when the IRS disagrees or has other internal priorities."[79] TAS has implemented various approaches to ensure that LTAs understand the types of cases that require TAOs. One approach involves coordinated discussions with all LTAs about case scenarios that may result in a TAO. These discussions help LTAs share experiences and learn more about what is necessary to resolve cases.[80] Heightened awareness of the importance of the TAO as an advocacy tool has increased the use of TAOs over the past four fiscal years, as shown in figure 4.10.

FIGURE 4.10, Number Of Taxpayer Assistance Orders Issued, FY 2009–2012[81]

Fiscal Year	Number of TAOs Issued
2009	45
2010	95
2011	422
2012	434

Of the 434 TAOs issued in FY 2012, 378 have been resolved.[82] The IRS complied with 348 of the resolved TAOs, a 92 percent compliance rate.[83] Figure 4.11 shows the areas that generated TAOs in FY 2012 and how they were resolved.

79 IRM 13.1.20.2(5) (Feb. 1, 2011).

80 The sessions are called *TAO Cafés*. These discussions, involving moderators and a detailed agenda, allow LTAs to ask questions about TAO authority under different scenarios.

81 Data obtained from TAMIS (Oct. 26, 2012).

82 *Id*. TAOs resolved includes TAOs that the IRS fully complied with, TAOs that were modified and the IRS complied with, and TAOs that TAS rescinded.

83 *Id*. TAOs complied with includes TAOs that the IRS fully compiled with and TAOs that were modified and the IRS complied with.

FIGURE 4.11, Taxpayer Assistance Orders Issued in FY 2012[84]

Type of Issue	Number of TAOs Issued	Resolution			
		IRS Complied	TAO Modified & IRS Complied	TAS Rescinded	In Process
Entity[85]	151	139	2	9	1
Refund	65	62	0	3	0
Criminal Investigation	55	13	1	4	37
Collection	52	41	3	2	6
Audit	43	34	2	3	4
Document Processing	27	20	2	3	2
Penalty	16	10	0	2	4
Appeals	13	10	1	1	1
Other	8	5	0	2	1
Interest	4	3	0	1	0
Total	**434**	**337**	**11**	**30**	**56**

Of the 56 remaining FY 2012 TAOs in process, 39 involve return preparer fraud cases that the IRS has appealed and elevated.[86] The IRS has suspended its decision on whether to comply with these 39 TAOs pending further discussion. Other unresolved TAOs involve a variety of issues where the IRS disagrees with TAS's position, appealing the TAO to a higher level. Some of the issues include disagreements over:

- The return of levy proceeds;
- Withdrawal of the filing of a Notice of Federal Tax Lien;
- IRS's calculation of the value of a taxpayer's assets or ability to pay in an Offer in Compromise evaluation;[87]
- Abatement of various penalties; and
- Reconsideration of a claim for refund.

These types of issues often involve an application and interpretation of law, or subjective analysis of facts, and the TAO appeal process provides for vigorous discussion and a thorough review of the facts, engaging IRS and TAS leadership in reaching a conclusion.

84 Data obtained from TAMIS (Oct. 26, 2012).

85 Entity issues include any taxpayer identification information such as name, taxpayer identification number, filing status, address, *etc*. The issue having the most significant impact on this category in FY 2012 is identity theft with 143 of the 151 TAOs issued related to cases involving identity theft. Data obtained from TAMIS (Oct. 1, 2012).

86 *See IRS Procedural Gaps Make it Difficult to Assist Taxpayers Victimized by Return Preparer Fraud, supra*.

87 When taxpayers submit an Offer in Compromise based on Doubt as to Collectability, the IRS generally will not accept the offer unless the amount offered exceeds an amount it believes represents the reasonable collection potential, based on evaluation of equity in assets and the taxpayer's ability to make payments over time. See IRM 5.8.4, *Investigation*.

Congressional Case Trends

TAS is responsible for responding to certain tax account inquiries sent to the IRS by members of Congress. As shown in Figure 4.11, entity, audit, and collection-related issues made up the top three categories of congressional inquiries in FY 2012.

FIGURE 4.12, Issues In Congressional Cases, FY 2011–FY 2012[88]

Issue Category	FY 2011	FY 2012	Percent Change
Entity Issues	1,625	5,251	223.1%
Audit Issues	3,111	2,573	-17.3%
Collection Issues	2,779	2,424	-12.8%
Document Processing Issues	2,623	2,048	-21.9%
Refund Issues	1,568	2,033	29.7%
Technical, Procedural, or Statute Issues	1,101	1,348	22.4%
Penalty Issues	1,145	1,053	-8.0%
Payment or Credit Issues	397	359	-9.6%
Appeals Issues	267	278	4.1%
Interest Issues	84	65	-22.6%
Other Issues	45	29	-35.6%
Criminal Investigation Issues	16	9	-43.8%
Total Congressional Issues	**14,761**	**17,470**	**18.4%**

The growth in congressional inquiries involving entity issues comes from two sources. The largest proportion is from stolen identity issues, and matches the growth seen in all TAS case receipts. The other source involves applications for exempt status.[89] Historically, a high proportion of inquiries from organizations seeking exempt status from the IRS come to TAS through congressional offices.[90] A review of a statistically valid sample of the 793 congressional exempt status application inquiries found that 33 percent are from organizations that lost their exempt status by failing to file three consecutive years of information

88 Data obtained from TAMIS, Oct. 1, 2011 (FY 2011) and Oct. 1, 2012 (FY 2012).

89 Organizations can seek recognition of exemption from federal income tax under IRC § 501(a) by filing the proper application with the IRS as described in Rev. Proc. 2012-9, § 3, 2012-2 I.R.B. 261.

90 In FY 2012, 66 percent of inquiries involving application for exempt status TAS received from congressional offices. In FY 2011, it was 49 percent.

returns or notices with the IRS.[91] These organizations contact their congressional representatives seeking to:

- Re-apply for exempt status;
- Dispute the automatic revocation; or
- Receive an explanation of the revocation and their options.

From FY 2008 through FY 2011, congressional inquiries declined, but they increased in FY 2012. As shown in Figure 4.12, issues relating to the FTHBC and adoption credit have contributed significantly to TAS congressional receipts in recent years.

FIGURE 4.13, TAS Congressional Receipts, FY 2008–FY 2012[92]

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Congressional Receipts	22,097	17,603	15,711	14,761	17,470
Total Case Receipts	274,051	272,404	298,933	295,904	219,666
% of Total Receipts	8.1%	6.5%	5.3%	5.0%	8.0%
Congressional Receipts Related to the Economic Stimulus Payment (ESP)[93]	10,320	4,264	127	22	
Congressional Receipts Related to FTHBC			3,243	2,018	399
Congressional Receipts Related to Adoption Credit				496	476

91 The Pension Protection Act of 2006, Pub. L. No. 109-280, § 1223, 120 Stat. 780, 1090 (Aug. 17, 2006), required most tax-exempt organizations to file an annual return or notice with the IRS, and the Act automatically revoked tax-exempt status for organizations that failed to file for three consecutive years. Generally, the Act imposed the filing requirement starting with tax year 2007, so the first organizations subject to automatic revocation failed to file 2007, 2008, and 2009 returns. TAS reviewed 259 of the 793 cases, for a 95 percent confidence level at plus or minus 5. For more information on this topic, see Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax Exempt Organizations, supra*.

92 Data obtained from TAMIS. TAS obtains the data on the first day following the end of the FY for FY 2008 through FY 2012.

93 See IRC § 6428.

Top 25 Case Advocacy Issues for FY 2012 by TAMIS* Receipts

Issue Code	Description	FY 2012 Cases
425	Stolen Identity	54,748
045	Pre-Refund Wage Verification Hold	18,012
71X	Levies	11,419
620	Reconsideration / Substitute for Return / IRC § 6020(b) / Audit	9,344
610	Open Audit (Non-Revenue Protection Strategy (RPS), Earned Income Tax Credit (EITC))	8,885
330	Processing Amended Return	8,783
63X-640	EITC Claims / Certification / Reconsideration / Recertification	7,441
310	Processing Original Return	6,250
020	Expedite Refund Request	5,726
060	IRS Offset	5,298
315	Unpostable/Reject	5,286
75X	Installment Agreement	4,449
340	Injured Spouse Claim	4,115
670	Closed Underreporter	3,696
090	Other Refund Inquiries / Issues	3,572
72X	Liens	3,527
540	Civil Penalties Other Than Trust Fund Recovery Penalty	3,498
040	Returned / Stopped Refunds	3,231
790	Other Collection Issues	2,996
520	Failure to File (FTF) / Failure to Pay (FTP) Penalty	2,822
390	Other Document Processing Issues	2,680
675	Combined Annual Wage Reporting / Federal Unemployment Tax Act (CAWR-FUTA)	2,650
660	Open Underreporter	2,629
010	Lost / Stolen Refunds	2,294
91X	Appeals	2,261
320	Math Error	2,083
Total Top 25 Receipts		**187,695**
Total TAS Receipts		**219,666**

* Taxpayer Advocate Management Information System.

Appendix Two

Advocacy Portfolio Advisor Assignments

Portfolio Assignment	Portfolio Owner	Location	Phone Number
Abusive Schemes / Refund Fraud	Kenyon, M	ND	701-237-8299
Accessing Taxpayers' Files	Todd, J	MO-Kansas City Campus	816-291-9019
Accounts Management Taxpayer Assurance Program Pre-Refund Program	Wess, D	TN-Memphis Campus	901-395-1700
Adoption Credit	Halker, S	FL-Jacksonville	904-665-0523
Amended Returns	Martinez, G	TX-Dallas	214-413-6520
Appeals – Examination Based Issues	Maiuro, D	CA-Sacramento	916-974-5191
Appeals Collection Based Issues	Leith, J	MD	410-962-8120
Audit Reconsiderations	Brunetti, A	UT-Ogden Campus	801-620-3000
Automated Collection System (ACS)	Lombardo, L	PA-Philadelphia	215-861-1237
Bankruptcy	Mettlen, A	PA-Pittsburgh	412-395-6423
BMF Information Reporting and Document Matching (IRDM/BMF) merged (CAWR/FUTA)	Morell, C	NY-Brookhaven Campus	631-654-6935
Collection / Allowable Living Expenses	Spisak, J	NY- Manhattan	212-436-1010
Correspondence Examination	Blinn, F	IN	317-685-7799
Customer Account Data Engine (CADE)	Logan, A	UT-Salt Lake City	801-799-6962
Disaster Response & Recovery	Washington, J	MS	601-292-4810
Domestic Violence Related Tax Issues	Davis, S	OH-Cleveland	216-522-8241
Earned Income Tax Credit (EITC) Outreach	Browne, R	GA-Atlanta	404-338-8085
EITC Compliance	Harrison, M	NJ	973-921-4376
Electronic Tax Administration	Martin, B	TN-Nashville	615-250-6015
Employment Tax Policy	Garvin, W	DE	302-286-1545
e-Services	Todaro, T	CA-Oakland	510-637-3079
Examination Strategy	Curran, D	CA-LA	213-576-3016
Exempt Organization Outreach	Guinn, P	MO-St. Louis	314-612-4371
Exempt Organizations (Application Approval Processing)	Eyman, N	OH-Cincinnati	513-263-3249
Farm Income & Taxation	Gilchrist, L	SD	605-377-1606
Federal Levy Payment Program (FPLP)	Moquin, K	CT	860-756-4550
Federal Tax Liens (Including Centralized Liens)	Pieger, G	District of Columbia	202-874-4280
Financially Distressed Taxpayers	Hensley, D	OK	405-297-4139
First Time Home Buyer's Credit	Lucas, D	TX-Houston	713-209-4781
Fraud/Victim Assistance	Swantz, C	AZ	602-636-9503
Health Care I (Individual)	Frierson, D	KS	316-352-7505
Health Care II (Business)	Taylor, S	IL-Chicago	312-566-3801
Health Care Outreach	DeTimmerman, P	IA	515-564-6880
Identity Protection Specialized Unit-Identity Theft	Benoit, F	MA-Andover Campus	978-247-9020
Identity Theft	Johnson, D	KY-Covington Campus	859-669-4013
Indian Tribal Governments	Wirth, W	NY-Buffalo	716-686-4820
Individual Information Reporting & Document Matching (Automated Underreporter)	McClendon, L	GA-Atlanta Campus	770-936-4543
Individual Taxpayer Identification Number (ITIN) Outreach	Blount, P	MI	313-628-3664
Injured Spouse	Morgan, M	KY-Louisville	502-572-2201

Portfolio Assignment	Portfolio Owner	Location	Phone Number
Innocent Spouse	Knowles, J	ID	208-387-2827
Installment Agreement Processing	Hough, C	WY	307-633-0881
Interest Computation Issues	Thompson, T	MT	406-441-1044
International Taxpayers	Vargas, C	Puerto Rico	787-622-8950
IRS Policy and Procedures on Accepting Electronic Taxpayer Records	Agosto, A	LA	504-558-3003
IRS Training on Taxpayer Rights	Zarrella, J	MA-Boston	617-316-2625
ITIN Processing	Farthing, N	TX-Austin Campus	512-460-4652
Levies	Wilde, B	AR	501-396-5820
Low Income Taxpayer Clinics (LITCs)	Leifeld, K	ME	207-622-8577
Math Error	Sonier, G	SC	803-765-5300
Military Taxation Issues	Douts, K	AK	907-271-6297
Multilingual Initiatives	Rolon, J	TX-Austin	512-499-5970
Nonfiler Strategy (Substitute for Return, Automated Substitute for Return)	Warren, J	MN	651-312-7874
Offer in Compromise (OIC)	Tehrani, B	NY-Brooklyn	718-488-3501
Office of Professional Responsibility	Juarez, V	PA-Philadelphia Campus	267-941-2357
Penalty Administration	Bates, P	IL-Springfield	217-862-6348
Powers of Attorney (Forms 2848, 8821)	Hawkins, D	AL	205-912-5634
Practitioner Priority Services	Szargowicz, L	RI	401-528-1916
Processing Payments	Ashurex, S	OR	503-415-7030
Return Preparer Penalties	Greene, S	NY-Albany	518-427-5412
Returned/Stopped Refunds	Johnson, B	WI	414-231-2391
Seizure and Sales	Crook, T	FL-Ft. Lauderdale	954-423-7676
TAS Confidentiality and IRC Section 6103	Champagne, J	NH	603-433-0571
Tax Exempt Entity Issues (Including government entities)	Juncewicz, T	NC	336-574-6213
Tax Forum Case Resolution Room	Sawyer, M	CA-Fresno	559-442-6418
Tax Forum Case Resolution Room	Adams, C	CA-Laguna Niguel	949-389-4790
Taxpayer Account Transcripts & Virtual Service Delivery	Fett, R	VT	802-859-1056
Taxpayer Assistance Center (TAC) Offices and Virtual Service Delivery	Mezger, W	WA	206-220-5704
Taxpayer Compliance Behavior	Halker, S	FL-Jacksonville	904-665-0523
Tip Reporting and Compliance	Alvear, K	NV	702-868-5180
Trust Fund Recovery Penalty (TFRP)	Campbell, M	VA	804-916-3500
U.S. Territories & Possessions	James, G	HI	808-566-2927
Undelivered Mail	Todd, J	MO-Kansas City Campus	816-291-9019

TABLE 1 Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issues(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Amabile, U.S. v., 109 A.F.T.R.2d (RIA) 1753 (E.D. Pa. 2012)	TP ordered to produce nonprivileged documents; TP ordered to produce privileged documents to court for in-camera review; TP's challenges dismissed as frivolous	Yes	IRS
Amabile, U.S. v., 2011 U.S. Dist. LEXIS 146350 (E.D. Pa. 2011)	TP's motion to quash summons dismissed; generalized Fifth Amendment assertion insufficient to defeat the IRS summons; TP ordered to produce nonprivileged documents; TP ordered to produce privileged documents to court for in-camera review	Yes	IRS
Augusto, U.S. v., 2011 U.S. Dist. LEXIS 105482 (N.D. Colo. 2011)	*Powell* requirements satisfied	Yes	IRS
AZIS v. United States, 109 A.F.T.R.2d (RIA) 2530 (S.D. Fla. 2012), *appeal dismissed,* No. 12-13929 (11th Cir. Sept. 10, 2012)	*Powell* requirements satisfied; enforcement of summons recommended; TP's motion to quash third-party summons denied	Yes	IRS
Bacon, U.S. v., 109 A.F.T.R.2d (RIA) 553 (E.D. Cal. 2012), *adopting* 108 A.F.T.R.2d (RIA) 7304 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Benice, U.S. v., 2012 U.S. Dist. LEXIS 65327 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Bennett, U.S. v., 108 A.F.T.R.2d (RIA) 5161 (W.D. Mo. 2011), *adopting* 108 A.F.T.R.2d (RIA) 5159 (W.D. Mo. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Berkowitz v. U.S., 108 A.F.T.R.2d (RIA) 6477 (D.S.C. 2011), *adopting* 2011 U.S. Dist. LEXIS 116161 (D.S.C. 2011)	*Powell* requirements satisfied; TP's motion to strike declaration denied; TP's motion to quash third-party summons dismissed; TP's Fifth Amendment objection lacked merit	Yes	IRS
Bilan v. U.S., 108 A.F.T.R.2d (RIA) 5089 (N.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; TP's motion to quash some third-party summonses dismissed for lack of subject matter jurisdiction	Yes	IRS
Bohn, U.S. v., 108 A.F.T.R.2d (RIA) 7459 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Bohn, U.S. v., 2011 U.S. Dist. LEXIS 123872 (E.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Brokaw, U.S. v., 2012 U.S. Dist. LEXIS 42970 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Brown v. U.S., 108 A.F.T.R.2d (RIA) 5851 (E.D.N.C. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2645 (E.D.N.C. 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed	Yes	IRS
Brownfield, U.S. v., 2011 U.S. Dist. LEXIS 75812 (W.D. Ky. 2011)	Civil contempt ordered	Yes	IRS
Calhoun, U.S. v., 108 A.F.T.R.2d (RIA) 7258 (E.D. Cal. 2011), *adopting* 108 A.F.T.R.2d (RIA) 6800 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Canatella v. U.S., 108 A.F.T.R.2d (RIA) 5256 (N.D. Cal. 2011), *appeal docketed*, No. 11-16827 (9th Cir. July 29, 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP's First and Fifth Amendment and marital privacy objections lacked merit	No	IRS
Canul, U.S. v., 108 A.F.T.R.2d (RIA) 5045 (N.D. Cal 2011), *adopted by* D.C. No. 5:11-cv-01658-LHK (N.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Capone, U.S. v., 2011 U.S. Dist. LEXIS 140064 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 139856 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Catlett v. U.S., 109 A.F.T.R.2d (RIA) 1410 (E.D. Wis. 2012)	TP's Fourth and Fifth Amendment objections lacked merit	Yes	IRS
Chongris, U.S. v., 2012 U.S. Dist. LEXIS 68545 (D. Mass. 2012), *adopting* 2012 U.S. Dist. LEXIS 69067 (D. Mass. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Cobb, U.S. v., 458 Fed. Appx. 587 (9th Cir. 2011), *aff'g* 2008 U.S. Dist. LEXIS 123508 (S.D. Cal. 2008)	Enforcement of summons upheld; TP's frivolous arguments lacked merit	Yes	IRS
Cotter, U.S. v., 2011 U.S. Dist. LEXIS 67633 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 67477 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Delanerolle, U.S. v., 109 A.F.T.R.2d (RIA) 1298 (S.D. Ohio 2012)	Enforcement of summons ordered	No	IRS
Devlin v. U.S., 108 A.F.T.R.2d (RIA) 6009 (D. Nev. 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed for lack of personal jurisdiction and subject matter jurisdiction	Yes	IRS
Ding, U.S. v., 2011 U.S. Dist. LEXIS 125837 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issues(s)	*Pro Se*	Decision
Duhamel, U.S. v., 2011 U.S. Dist. LEXIS 71951 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 72149 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Dunich-Kolb v. U.S., 108 A.F.T.R.2d (RIA) 5165 (D.N.J. 2011)	TP's untimely motion to quash third-party summons dismissed for lack of subject matter jurisdiction	No	IRS
Estavillo, U.S. v., 2012 U.S. Dist. LEXIS 60138 (N.D. Cal. 2012)	Enforcement of summons ordered; documents ordered are not privileged	No	IRS
Fisette, U.S. v., 2012 U.S. Dist. LEXIS 27176 (D. Mass. 2012), *adopted by* D.C. No. 1:11-mc-91311-DPW (D. Mass 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Garcia, U.S. v., 2012 U.S. Dist. LEXIS 59295 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Gillies, U.S. v., 2011 U.S. Dist. LEXIS 141982 (N.D. Cal. 2011), *adopting* 108 A.F.T.R.2d (RIA) 7241 (N.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Gillies, U.S. v., 2012 U.S. Dist. LEXIS 50378 (N.D. Cal. 2012), *adopting* 2012 U.S. Dist. LEXIS 50383 (N.D. Cal. 2012)	Civil contempt ordered	Yes	IRS
Giroud, U.S. v., 2012 U.S. Dist. LEXIS 63446 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Gomez, U.S. v., 107 A.F.T.R.2d (RIA) 2428 (E.D. Cal. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2338 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	No	IRS
Gonzalez v. U.S., 108 A.F.T.R.2d (RIA) 6652 (N.D. Ill. 2011)	*Powell* requirements satisfied; TP's motion to quash summons dismissed; TP's bad faith argument rejected; TP failed to demonstrate that case has been referred to DOJ	No	IRS
Gonzalez v. U.S., 108 A.F.T.R.2d (RIA) 6911 (D.N.J. 2011)	TP's motion to quash summons dismissed; TP's bad faith argument rejected; TP failed to demonstrate that case has been referred to DOJ	No	IRS
Grandstaff, U.S. v., 108 A.F.T.R.2d (RIA) 6805 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Gray v. U.S., 2012 U.S. Dist. LEXIS 499 (D. Conn. 2012)	TP's motion to quash third-party summons dismissed for lack of personal jurisdiction and subject matter jurisdiction	Yes	IRS
Gutierrez, U.S. v., 108 A.F.T.R.2d (RIA) 5540 (N.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; TP may not desig-nate an attorney to provide testimony under IRC § 7602	No	IRS
Hill v. IRS, 109 A.F.T.R.2d (RIA) 646 (M.D. Fla. 2012), *adopting* 109 A.F.T.R.2d (RIA) 644 (M.D. Fla. 2011)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS
Howard, U.S. v., 2011 U.S. Dist. LEXIS 133643 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
In re Does, 108 A.F.T.R.2d (RIA) 7499 (E.D. Cal. 2011)	Court authorized issuance of "John Doe" summons to State of California to obtain information about inter-family property transfers for little or no consideration	Not applicable*	IRS
Jaha, U.S. v., 2011 U.S. Dist. LEXIS 118520 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Joaquin, U.S. v., 107 A.F.T.R.2d (RIA) 2716 (N.D. Cal. 2011)	Enforcement of summons ordered	Yes	IRS
Jordan v. U.S., 108 A.F.T.R.2d (RIA) 6824 (S.D. Ohio 2011), *adopting* 108 A.F.T.R.2d (RIA) 6821 (S.D. Ohio 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP received adequate notice; TP's failed to demonstrate that case has been referred to DOJ; TP's Fourth Amendment and privacy objections lacked merit	Yes	IRS
Kahler, U.S. v., 2012 U.S. Dist. LEXIS 64519 (E.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Kalter, U.S. v., 2011 U.S. Dist. Lexis 142601 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Kennedy, U.S. v., 2012 U.S. Dist. LEXIS 65191 (W.D. Wash. 2012), *adopted by* D.C. No. 3:12-mc-05013-BHS (W.D. Wash. 2012)	Enforcement of summons ordered	Yes	IRS
Koester, U.S. v., 2012 U.S. Dist. LEXIS 53102 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Kum, U.S. v., 2011 U.S. Dist. LEXIS 133647 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Landworth, U.S. v., 2011 U.S. Dist. LEXIS 128521 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Lavoie, U.S. v., 2011 U.S. Dist. LEXIS 74202 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 74491 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS

* A John Doe Summons must be authorized by the court prior to issuance. It is an *ex parte* proceeding where the only party is the United States.

Appendix Three

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issues(s)	*Pro Se*	Decision
Lewis v. U.S., 109 A.F.T.R.2d (RIA) 1756 (E.D. Cal. 2012)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed for lack of standing and subject matter jurisdiction; TP's Fourth Amendment objection lacked merit	Yes	IRS
Lonsdale, U.S. v., 109 A.F.T.R.2d (RIA) 1601 (E.D. Cal. 2012); *adopted by* D.C. No. 2:12-mc-00004-KJM-EFB (E.D. Cal. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Lozano, U.S. v., 108 A.F.T.R.2d (RIA) 5960 (S.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Luna, U.S. v., 109 A.F.T.R.2d (RIA) 2090 (N.D. Cal. 2012)	Enforcement of summons ordered	Yes	IRS
Lund, U.S. v., 109 A.F.T.R.2d (RIA) 7513 (D. Or. 2011), *reconsideration denied by* 109 A.F.T.R.2d (RIA) 913 (D. Or. 2012), *appeal docketed*, No. 12-35351 (9th Cir. May 4, 2012)	*Powell* requirements satisfied; TP's motion to dismiss for lack of jurisdiction denied; TP's Fourth and Fifth Amendment objections lacked merit	Yes	IRS
Lyons, U.S. v., 107 A.F.T.R.2d (RIA) 2733 (E.D. Tex. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2732 (E.D. Tex. 2011)	Enforcement of summons ordered; summons not overbroad	Yes	IRS
MacAlpine v. U.S., 109 A.F.T.R.2d (RIA) 1719 (W.D.N.C. 2012), *reconsideration denied by* 2012 U.S. Dist. LEXIS 74511 (W.D.N.C. 2012)	TP's untimely motion to quash third-party summons dismissed for lack of personal and subject matter jurisdiction	Yes	IRS
Macbeath, U.S. v., 2011 U.S. Dist. LEXIS 139392 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Maccaughern, U.S. v., 2012 U.S. Dist. LEXIS 69477 (D. Utah 2012), *adopting* 2012 U.S. Dist. LEXIS 69482 (D. Utah 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Mahallati, U.S. v., 107 A.F.T.R.2d (RIA) 2510 (N.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Mayberry v. U.S., 108 A.F.T.R.2d (RIA) 5497 (E.D.N.C. 2011)	TP's untimely motion to quash third-party summons dismissed for lack of personal jurisdiction and subject matter jurisdiction	Yes	IRS
Mayley v. U.S., 108 A.F.T.R.2d (RIA) 7000 (D.S.C. 2011), *adopting* 108 A.F.T.R.2d (RIA) 6995 (D.S.C. 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP's Fourth and Fifth Amendment objections lacked merit	Yes	IRS
McDoneld, U.S. v., 108 A.F.T.R.2d (RIA) 6895 (E.D. La. 2011), *adopting* 108 A.F.T.R.2d (RIA) 6893 (E.D. La. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
McDonnell, U.S. v., 2011 U.S. Dist. LEXIS 120953 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 120954 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
McFarland, U.S. v., 2012 U.S. Dist. LEXIS 50330 (W.D. Wash. 2012), *adopted by* D.C. 3:12-mc-05008-BHS (W.D. Wash 2012)	Enforcement of summons ordered	Yes	IRS
McNorton, U.S. v., 108 A.F.T.R.2d (RIA) 7507 (D. Haw. 2011), *adopting* 108 A.F.T.R.2d (RIA) 7506 (D. Haw. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Melick, U.S. v., 108 A.F.T.R.2d (RIA) 6780 (D.N.H. 2011), *appeal docketed*, No. 11-2245 (1st Cir. Oct. 25, 2011)	Civil contempt ordered; TP's objections for insufficient service of process rejected	No	IRS
Miller, U.S. v., 2011 U.S. Dist. LEXIS 104150 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Montagne, U.S. v., 2012 U.S. Dist. LEXIS 57627 (D. Minn. 2012), *adopting* 2012 U.S. Dist. LEXIS 57935 (D. Minn. 2012)	*Powell* requirements satisfied; enforcement of summons ordered; TP's motion to quash summons dismissed	Yes	IRS
Navarro, U.S. v., 817 F.Supp.2d 25 (D.P.R. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	No	IRS
Nguyen v. U.S., 108 A.F.T.R.2d (RIA) 5311 (M.D. Fla. 2011), *further proceedings in unpublished order*, District Ct. Docket No. 3:11-cv-536-J-37TEM (M.D. Fla. 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons initially held in abeyance because of alleged improper purpose, then denied by court	No	IRS
Nisbett, U.S. v., 108 A.F.T.R.2d (RIA) 7315 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons recommended	Yes	IRS
Odaly, U.S. v., 2012 U.S. Dist. LEXIS 65804 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Olson, U.S. v., 109 A.F.T.R.2d (RIA) 549 (N.D. Cal. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Olvany, U.S. v., 109 A.F.T.R.2d (RIA) 790 (M.D. Pa. 2012)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government; TP's objection to court's personal jurisdiction rejected	Yes	IRS

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issues(s)	*Pro Se*	Decision
Orona, U.S. v., 108 A.F.T.R.2d (RIA) 5477 (N.D. Tex. 2011), *adopting* 108 A.F.T.R.2d (RIA) 5475 (N.D. Tex. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Otten, U.S. v., 109 A.F.T.R.2d (RIA) 763 (W.D. Wis. 2012)	Enforcement of summons ordered	Yes	IRS
Papazian, U.S. v., 2011 U.S. Dist. LEXIS 147544 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Paul, U.S. v., 2011 U.S. Dist. LEXIS 155398 (M.D. Fla. 2011), *earlier proceeding* 2011 U.S. Dist. LEXIS 100999 (M.D. Fla. 2011)	Motion for civil contempt granted; TP fined $200 per day; If fines exceed $1,000 prior to compliance with summons arrest warrant will be issued	Yes	IRS
Peterson v. U.S., 109 A.F.T.R.2d (RIA) 1099 (D. Neb. 2012), *appeal dismissed*, No. 12-2373 (8th Cir. Sept. 5, 2012)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP received sufficient notice; TP failed to demonstrate that case has been referred to DOJ; TP's bad faith argument rejected; TP's Fourth Amendment and privacy objections lacked merit	Yes	IRS
Peterson v. U.S., 109 A.F.T.R.2d (RIA) 1287 (E.D. Pa. 2012)	TP's motion to quash third-party summons dismissed; TP received sufficient notice; TP failed to demonstrate that case has been referred to DOJ; TP's bad faith argument rejected; TP's Fourth Amendment, Nebraska Constitution, and privacy objections lacked merit	Yes	IRS
Pettinger, U.S. v., 108 A.F.T.R.2d (RIA) 6565 (E.D. Tex. 2011), *adopting* 108 A.F.T.R.2d (RIA) 6565 (E.D. Tex. 2011)	Enforcement of summons ordered; summons not overbroad	Yes	IRS
Phelan, U.S. v., 2011 U.S. Dist. LEXIS 98702 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Poole, U.S. v., 2011 U.S. Dist. LEXIS 96400 (E.D. Mich. 2011), *adopting* 2011 U.S. Dist. LEXIS 96418 (E.D. Mich. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; IRS's motion for show cause hearing granted	Yes	IRS
Porter v. U.S Dept. of Treas., 2012 U.S. Dist. LEXIS 64911 (M.D. Fla. 2012), *adopting* 2012 U.S. Dist. LEXIS 64910 (M.D. Fla. 2012)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS
Puccio, U.S. v., 2011 U.S. Dist. LEXIS 69927 (D. Mass. 2011)	*Powell* requirements satisfied; TP's motion to quash summons dismissed	Yes	IRS
Puccio, U.S. v., 812 F. Supp. 2d 105 (D. Mass. 2011)	Civil contempt ordered	Yes	IRS
Reid-Bills, U.S. v., 108 A.F.T.R.2d (RIA) 7245 (E.D. Cal. 2011)	Civil contempt ordered	Yes	IRS
Ring, U.S. v., 2011 U.S. Dist. LEXIS 116688 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 116642 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Rubin, U.S. v., 2011 U.S. Dist. LEXIS 127408 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Rubin, U.S. v., 2012 U.S. Dist. LEXIS 70042 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Rubin, U.S. v., 2012 U.S. Dist. LEXIS 72658 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Ruggieri, U.S. v., 2012 U.S. Dist. LEXIS 22054 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Ryland, U.S. v., 2011 U.S. Dist. LEXIS 134735 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Salmonsen, U.S. v., 2012 U.S. Dist. LEXIS 46368 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Sanchez, U.S. v., 2012 U.S. Dist. LEXIS 60191 (C.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Sanders, U.S. v., 2012 U.S. Dist. LEXIS 63008 (D. Colo. 2012), *adopting* 2012 U.S. Dist. LEXIS 63010 (D. Colo. 2012)	Enforcement of summons ordered	Yes	IRS
Shaw v. U.S., 109 A.F.T.R.2d (RIA) 1335 (M.D. Fla. 2012), *vacating* 109 A.F.T.R.2d (RIA) 1331 (M.D. Fla. 2011), *appeal docketed*, No. 12-13449 (11th Cir. June, 29, 2012)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS
Sheehan, U.S. v., 2012 U.S. Dist. LEXIS 26473 (E.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Simoneau, U.S. v., 2011 U.S. Dist. LEXIS 123093 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 123097 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Smith, U.S. v., 2011 U.S. Dist. LEXIS 123103 (D.N.H. 2011), *adopting* 2011 U.S. Dist. LEXIS 123104 (D.N.H. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	No	IRS

Appendix Three

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issues(s)	*Pro Se*	Decision
Springston, U.S. v., 2011 U.S. Dist. LEXIS 146330 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
St. John, U.S. v., 108 A.F.T.R.2d (RIA) 7371 (M.D. Fla. 2011), *adopting* 108 A.F.T.R.2d (RIA) 7372 (M.D. Fla. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Stevens, U.S. v., 2012 U.S. Dist. LEXIS 15092 (D.N.H. 2012), *adopting* 2012 U.S. Dist. LEXIS 15089 (D.N.H. 2012)	*Powell* requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Talbot v. U.S., 108 A.F.T.R.2d (RIA) 5309 (D. Ariz. 2011), *appeal dismissed*, No. 11-17166 (9th Cir. Nov. 11, 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP's arguments for bad faith and improper service of process rejected; TP failed to demonstrate that case has been referred to DOJ; TP's federal privacy law objection lacked merit	Yes	IRS
Vasquez, U.S. v., 2011 U.S. Dist. LEXIS 123377 (C.D. Cal. 2011)	*Powell* requirements satisfied	Yes	IRS
Villarreal v. U.S., 109 A.F.T.R.2d (RIA) 1522 (D. Colo. 2012), *adopting* 109 A.F.T.R.2d (RIA) 1516 (D. Colo. 2011), *appeal docketed*, No. 12-1131 (10th Cir. Apr. 9, 2012)	*Powell* requirements satisfied; enforcement of summons ordered; government's motion for summary judgment with respect to petition to quash summons granted; TP's bad faith argument rejected	No	IRS
Viscarra, U.S. v., 109 A.F.T.R.2d (RIA) 1095 (E.D. Cal. 2012), *adopting* 109 A.F.T.R.2d (RIA) 593 (E.D. Cal. 2012)	*Powell* requirements satisfied; enforcement of summons ordered; TPs received proper notice	Yes	IRS
Wankel, U.S./IRS v., 109 A.F.T.R.2d (RIA) 1671 (10th Cir. 2012), *aff'g* 107 A.F.T.R.2d (RIA) 2278 (D.N.M. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Warrior, U.S. v., 108 A.F.T.R.2d (RIA) 7489 (S.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Wildes, U.S. v., 109 A.F.T.R.2d (RIA) 1408 (E.D. Cal. 2012)	*Powell* requirements satisfied; enforcement of summons recommended	Yes	IRS
Williams v. U.S., 453 Fed. Appx. 532 (5th Cir. 2011) (per curiam), *aff'g* 107 A.F.T.R.2d (RIA) 1453 (N.D. Tex. 2011)	Dismissal of TPs' motion to quash third-party summons for lack of subject matter jurisdiction upheld	Yes	IRS
Wright, U.S. v., 2012 U.S. Dist. LEXIS 59009 (S.D. Ohio 2012)	*Powell* requirements satisfied	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedules C, E, F)			
Action Recycling, Inc. v. U.S., 109 A.F.T.R.2d (RIA) 1311 (E.D. Wash. 2012), *appeal docketed*, No. 12-35338 (9th Cir. Apr. 30, 2012)	*Powell* requirements satisfied; TP's motion to quash summons dismissed	No	IRS
Advanced Chiropractic Health & Wellness Ctr. v. U.S., 2011 U.S. Dist. LEXIS 123398 (N.D. Ohio 2011)	TP's motion to quash third-party summons denied for lack of standing and subject matter jurisdiction	Yes	IRS
Bishop, U.S. v., 109 A.F.T.R.2d (RIA) 890 (E.D. Cal. 2012), *adopting* 109 A.F.T.R.2d (RIA) 667 (E.D. Cal. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Bladow, U.S. v., 2012 U.S. Dist. LEXIS 56689 (S.D. Cal. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Briggs, U.S. v., 107 A.F.T.R.2d (RIA) 2420 (E.D. Cal. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2321 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	No	IRS
Capps, U.S. v., 109 A.F.T.R.2d (RIA) 942 (E.D. Cal. 2012), *adopting* 109 A.F.T.R.2d (RIA) 669 (E.D. Cal. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Carranco, U.S. v., 108 A.F.T.R.2d (RIA) 7518 (E.D. Cal. 2011), *adopting* 108 A.F.T.R.2d (RIA) 7313 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Day v. U.S., 108 A.F.T.R.2d (RIA) 6266 (D. Colo. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; TP's bad faith argument rejected; TPs' relevance objection rejected; statute of limitations not defense to summons	No	IRS
Dougan v. U.S., 108 A.F.T.R.2d (RIA) 6663 (E.D. Cal. 2011), *adopting* 108 A.F.T.R.2d (RIA) 5847 (E.D. Cal. 2011)	*Powell* requirements satisfied; TP's motion to quash summons dismissed; TP's arguments for overbreadth and relevance rejected; attorney-client privilege does not protect bank records from IRS summons	No	IRS
Gangi v. U.S., 453 Fed. Appx. 255 (3d Cir. 2011), *aff'g* 107 A.F.T.R.2d (RIA) 1542 (D.N.J. 2011)	Summons enforcement upheld; TP's Fifth Amendment objection lacked merit; TP's bad faith argument rejected; statute of limitations not defense to summons	No	IRS
Gehrisch, U.S. v., 108 A.F.T.R.2d (RIA) 6373 (S.D. Cal. 2011), *appeal dismissed*, No. 11-56665 (9th Cir. June 25, 2012)	Civil contempt denied without prejudice; TP's motion to dismiss contempt proceeding denied	Yes	Split

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issues(s)	*Pro Se*	Decision
Grant v. U.S., 108 A.F.T.R.2d (RIA) 5872 (N.D. Cal. 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP's bad faith argument rejected; TP failed to demonstrate that case has been referred to DOJ; TP's Fourth and Fifth Amendment objections lacked merit	Yes	IRS
Grant v. U.S., 2012 U.S. Dist. LEXIS 2972 (C.D. Cal. 2012)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS
Hampton v. United States, 110 A.F.T.R.2d (RIA) 5198 (W.D. Mo. 2012), *appeal docketed*, No. 12-2861 (8th Cir. Aug. 8, 2012)	*Powell* requirements satisfied; enforcement of summons recommended	Yes	IRS
Hill, U.S. v., 2012 U.S. Dist. LEXIS 73696 (W.D. Mo. 2012), *adopting* 2012 U.S. Dist. LEXIS 73699 (W.D. Mo. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Johnson, U.S. v., 2012 U.S. Dist. LEXIS 22357 (D. Minn. 2012), *adopting* 109 A.F.T.R.2d (RIA) 942 (D. Minn. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	No	IRS
Kwolek v. U.S., 107 A.F.T.R.2d (RIA) 2610 (N.D. Cal. 2011)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP's bad faith argument rejected	No	IRS
Kwolek v. U.S., 108 A.F.T.R.2d (RIA) 5413 (W.D. Pa. 2011)	TP's motion to quash third-party summons denied because of collateral estoppel	No	IRS
Lano Equip., Inc., U.S. v., 2012 U.S. Dist. LEXIS 77900 (D. Minn. 2012), *adopted by* 2012 U.S. Dist. LEXIS 77392 (D. Minn. 2012)	*Powell* requirements satisfied; enforcement of summons ordered; summons not overbroad	No	IRS
Lara-Davila, U.S. v., 107 A.F.T.R.2d (RIA) 2519 (E.D. Cal. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2335 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Looby v. U.S., 109 A.F.T.R.2d (RIA) 654 (D. Neb. 2012)	*Powell* requirements satisfied; enforcement of summons ordered; TP's motion to quash third-party summons dismissed	No	IRS
Madewell, U.S. v., 2012 U.S. Dist. LEXIS 17956 (E.D. Cal. 2012)	*Powell* requirements satisfied	Yes	IRS
Miccosukee Tribe of Indians of Fla. v. U.S., 108 A.F.T.R.2d (RIA) 5572 (S.D. Fla. 2011), *aff'd*, No. 11-14825 (11th Cir. Oct. 15, 2012)	*Powell* requirements satisfied; TP's motion to quash third-party summons dismissed; TP's claim of tribal sovereign immunity inapplicable to case; TP's motion to stay pending appeal denied except for two-week period	No	IRS
Ottovich, U.S v., 108 A.F.T.R.2d (RIA) 6092 (N.D. Cal. 2011), *aff'd*, No. 11-17326 (9th Cir. Oct. 16, 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Patel, U.S. v., 109 A.F.T.R.2d (RIA) 421 (E.D. Cal. 2011), *adopting* 108 A.F.T.R.2d (RIA) 6749 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
PricewaterhouseCoopers, LLP, U.S. v., 2012 U.S. Dist. LEXIS 64517 (D. Minn. 2012), *adopting* 2012 U.S. Dist. LEXIS 63808 (D. Minn. 2012)	*Powell* requirements satisfied; enforcement of summons ordered; documents not privileged and any claim of privilege is waived by lack of motion to quash or intervene	No	IRS
Princinsky, U.S. v., 2012 U.S. Dist. LEXIS 64406 (E.D. Mich. 2012), *adopting* 2011 U.S. Dist. LEXIS 155019 (E.D. Mich. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Rouse, U.S. v., 2011 U.S. Dist. LEXIS 77028 (M.D. Fla. 2011), *adopting* 2011 U.S. Dist. LEXIS 77025 (M.D. Fla. 2011)	*Powell* requirements satisfied; enforcement of summons ordered; electronic data is subject to summons under IRC § 7602	Yes	IRS
Russo, U.S. v., 107 A.F.T.R.2d (RIA) 2536 (S.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Sakai, U.S. v., 107 A.F.T.R.2d (RIA) 2765 (D. Haw. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2757 (D. Haw. 2011)	*Powell* requirements satisfied; costs awarded to government; enforcement of summons ordered; TPs' bad faith and improper purpose arguments rejected; TPs' blanket Fifth Amendment objection lacked merit; TP ordered to produce nonprivileged documents; TP ordered to produce privileged documents to court for in-camera review; TPs' work-product objection lacked merit	No	IRS
Schleweis, U.S. v., 108 A.F.T.R.2d (RIA) 5297 (D. Colo. 2011), *appeal dismissed*, No. 11-1329 (10th Cir. Nov. 23, 2011)	*Powell* requirements satisfied; enforcement of summons ordered; TP may assert Fifth Amendment privilege against self-incrimination on behalf of himself, but not for corporation	Yes	IRS
Sendatsu v. U.S., 109 A.F.T.R.2d (RIA) 1188 (D. Haw. 2012), *adopting* 109 A.F.T.R.2d (RIA) 1184 (D. Haw. 2012)	TPs' motion to quash third-party summons dismissed for lack of standing and subject matter jurisdiction	No	IRS
Stiner, U.S. v., 107 A.F.T.R.2d (RIA) 2421 (E.D. Cal. 2011), *adopting* 107 A.F.T.R.2d (RIA) 2316 (E.D. Cal. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS

Appendix Three

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issues(s)	*Pro Se*	Decision
Viewtech, Inc. v. U.S., 653 F.3d 1102 (9th Cir. 2011), *aff'g* 104 A.F.T.R.2d (RIA) 7101 (S.D. Cal. 2009)	TPs' motion to quash third-party summons dismissed for lack of standing	No	IRS
Watson v. U.S. (IRS), 2012 U.S. App. LEXIS 4110 (5th Cir. 2012) (per curiam), *aff'g* 7:10-CV-1200 (W.D. Tex.)	*Powell* requirements satisfied; government's motion to dismiss petition to quash summons granted	Yes	IRS
White v. U.S., 108 A.F.T.R.2d (RIA) 6813 (N.D. Fla. 2011), *adopting* 108 A.F.T.R.2d (RIA) 6812 (N.D. Fla. 2011)	TP's motion to quash third-party summons denied	Yes	IRS
Williams, U.S. v., 109 A.F.T.R.2d (RIA) 1855 (S.D. Miss. 2012), *adopting* 109 A.F.T.R.2d (RIA) 1854 (S.D. Miss. 2012)	*Powell* requirements satisfied; enforcement of summons ordered	Yes	IRS
Zerjav, U.S. v., 108 A.F.T.R.2d (RIA) 6934 (E.D. Mo. 2011), *reconsideration denied by* D.C. No. 4:11-mc-353 (E.D. Mo. 2011)	*Powell* requirements satisfied; enforcement of summons ordered	No	IRS

Table 2 Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Ani v. Comm'r, T.C. Summ. Op. 2011-119	6662(b)(2) - TPs (H&W) failed to maintain contemporaneous books, logs, or records to substantiate deductions relating to rental properties	Yes	IRS
Baker v. Comm'r, T.C. Summ. Op. 2011-95	6662(b)(1) - TPs (H&W) relied on same CPA for years and acted in good faith and with reasonable cause in taking certain deductions	No	TP
Bates v. Comm'r, 436 Fed. Appx. 790 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-152	6662(b)(1) - TP(H) negligent in failing to include TP(W) social security benefits, and did not maintain adequate books and records	Yes	IRS
Brashear v. Comm'r, T.C. Memo. 2012-136	6662(b)(1) & (2) - TP substantially understated income and did not show reasonable cause because he failed to seek professional tax advice or otherwise determine proper tax treatment	Yes	IRS
Bronstein v. Comm'r, 138 T.C. No. 21 (2012)	6662(b)(2) - TP substantially understated income and failed to provide substantial authority or reasonable basis for the position taken on tax return	No	IRS
Brown v. Comm'r, T.C. Memo. 2012-28	6662(b)(2) - TP substantially understated income and did not argue that reasonable cause applies	Yes	IRS
Butler v. Comm'r, T.C. Memo. 2012-72	6662(b)(1) & (2) - TPs (H&W) showed reasonable cause and acted in good faith by relying upon competent and qualified advisors	No	TP
Campbell v. Comm'r, 658 F.3d 1255 (11th Cir. 2011), *aff'g* 134 T.C. 20 (2010)	6662(b)(2) - TP substantially understated income and did not show good faith or that there was reasonable cause for omitting a *qui tam* payment	No	IRS
Crane v. Comm'r, T.C. Memo. 2011-256	6662(b)(1) - TPs (H&W) had concerns about an exclusion but made no effort to determine the proper tax treatment of retirement income	No	IRS
Dennis v. Comm'r, T.C. Summ. Op. 2011-134	6662(b)(2) - TP acted in good faith in not reporting income from a settlement because she was unfamiliar with tax law, sought professional advice, and had reasonable cause for her position; regarding separate unreported wages, she did not act reasonably, so penalty was proper	Yes	Split
Dunlap v. Comm'r, T.C. Memo. 2012-126	6662(b)(2) - TPs (7 consolidated cases) not liable for erroneously deducting façade easement donation because they used a "qualified appraiser" and made a good-faith investigation into the value of the easement	No	TP
Farias v. Comm'r, T.C. Memo. 2011-248	6662(b)(1) - TP negligent for claiming personal expenses as business expenses and for failing to maintain records to substantiate deductions; reliance on tax return preparer unreasonable because she did not provide all necessary documentation to the preparer	Yes	IRS
Gustashaw v. Comm'r, T.C. Memo. 2011-195, *appeal docketed*, No. 11-15406 (11th Cir. Nov. 18, 2011)	6662(b)(1) - TPs' (H&W) reliance on tax opinion letter unreasonable because they should have known about law firm's inherent conflict of interest	No	IRS
Hristov v. Comm'r, T.C. Memo. 2012-147	6662(b)(2) - TPs' (H&W) reliance on unqualified tax return preparer and advisor with clear conflict of interest was not reasonable	No	IRS
Hyde v. Comm'r, T.C. Memo. 2011-131	6662(b)(1) & (2) - TP not credible in claiming she never received a Form 1099-MISC and did not have to report the nonemployee compensation she received	Yes	IRS
Ioane v. Comm'r, 442 Fed. Appx. 269 (9th Cir. 2011), *aff'g* T.C. Memo. 2009-68	6662(b)(1) & (2) - TPs (H&W) failed to meet their burden of showing underpayments were not a result of negligence	Yes	IRS
Iverson v. Comm'r, T.C. Memo. 2012-19	6662(b)(2) - TPs (H&W) reasonably and in good faith relied on their accountant in claiming their disallowed losses	No	TP
Juha v. Comm'r, T.C. Memo. 2012-68	6662(b)(1) & (2) - TPs (H&W) did not have reasonable cause to ignore their Form 1099-DIV, reflecting ordinary dividends from Canadian entities, and relied on an advisor who lacked experience and expertise	Yes	IRS
Kim v. Comm'r, 679 F.3d 623 (7th Cir. 2012), *aff'g* No. 11902-10 (T.C. 2011)	6662(b)(2) - TP substantially understated income, provided no substantial authority for the tax treatment claimed on his return, and did not establish reasonable basis for the tax treatment	No	IRS
LaPoint v. Comm'r, T.C. Memo. 2012-107	6662(b)(2) - TP reasonably relied on professional tax preparer in deducting payments made pursuant to postnuptial agreement; however, TP offered no reasonable cause for failure to report interest income	No	Split
Lyseng v. Comm'r, T.C. Memo. 2011-226	6662(b)(2) - TP provided adequate records to substantiate a portion of his claimed deductions, but failed to provide substantiation for others	No	Split

Appendix Three

Table 2: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
McGowan v. Comm'r, T.C. Memo. 2011-186	6662(b)(1) & (2) - TP reasonably believed that a portion of a sexual harassment settlement payment was not taxable and in good faith did not report that portion on her tax return	Yes	TP
Miller v. Comm'r, T.C. Memo. 2011-219	6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith in claiming rental real estate losses	No	TP
Mitchell v. Comm'r, 138 T.C. No. 16 (2012)	6662(b)(2) - TP acted with reasonable cause and in good faith in attempting to comply with the requirements of making charitable conservation easement contribution	No	TP
Moore v. Comm'r, T.C. Memo. 2011-173	6662(b)(2) - TP lacked substantial authority and reasonable cause for claiming to be a professional gambler; TP made little effort to determine the proper tax treatment of his gambling activity	Yes	IRS
Neri v. Comm'r, T.C. Memo. 2012-71	6662(b)(1) & (2) - TPs (H&W) acted with reasonable cause and in good faith in omitting an arbitration award from gross income	No	TP
Nipps v. Comm'r, T.C. Memo. 2011-267	6662(b)(2) - TP reasonably relied on bank's lack of withholding of Federal income tax as basis for position that inherited IRA distribution was not taxable	Yes	TP
Nolder v. Comm'r, T.C. Summ. Op. 2012-50	6662(b)(1) - TP reasonably relied upon his tax preparer, providing credible testimony and reasonable cause to claim many of the disallowed deductions	Yes	TP
Olsen v. Comm'r, T.C. Summ. Op. 2011-131	6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith in making an isolated error in transcribing information from a Schedule K-1 while using tax return preparation software	Yes	TP
Park v. Comm'r, 136 T.C. 569 (2011), *appeal docketed*, No. 12-1058 (D.C. Cir. Feb. 2, 2012)	6662(b)(1) & (2) - TPs (H&W), non-resident aliens, substantially understated income and were negligent for making little to no effort in determining the proper tax treatment of gambling and interest income	No	IRS
Perry v. Comm'r, T.C. Summ. Op. 2011-76	6662(b)(1) - TP was negligent by overstating and not substantiating disallowed deductions; TP failed to show that his tax preparer was a competent professional with sufficient expertise to justify reliance that he provided all necessary information, or that he relied in good faith on the preparer's judgment	Yes	IRS
Roberts v. Comm'r, T.C. Memo. 2012-144	6662(b)(1) - TP's reliance on professional tax advice was reasonable	No	TP
Sewards v. Comm'r, 138 T.C. No. 15 (2012), *appeal docketed*, No. 12-72985 (9th Cir. Sept. 18, 2012)	6662(b)(2) - TPs (H&W) in good faith, took reasonable efforts to assess their proper tax liability and had reasonable cause for underpayment	No	TP
Shelton v. Comm'r, T.C. Memo. 2011-266	6662(b)(1) - TP did not act with reasonable cause and in good faith in claiming alimony deduction when divorce decree explicitly stated neither party was entitled to alimony	Yes	IRS
Stromme v. Comm'r, 138 T.C. No. 9 (2012)	6662(b)(1) - TPs (H&W) had reasonable cause to take the reporting position they did, given the ambiguity in this area of the law	No	TP
Swanson v. Comm'r, T.C. Memo. 2011-156	6662(b)(1) - TPs (H&W) could not negate the negligence penalty through reliance on a transaction's promoters or other advisor with a conflict of interest	No	IRS
Van der Lee v. Comm'r, T.C. Memo. 2011-234, *appeal docketed*, No. 12-226 (2d Cir. Jan. 19, 2012)	6662(b)(1) - TPs (H&W) failed to show reasonable cause or good faith in relying on tax preparer because they did not provide him all necessary and relevant information	No	IRS
Van Wickler v. Comm'r, T.C. Memo. 2011-196	6662(b)(1) & (2) - TPs (H&W) in good faith took reasonable efforts to assess proper tax liability and reasonably relied on CPA's expertise	Yes	TP
Weinberger v. Comm'r, T.C. Summ. Op. 2012-41	6662(b)(1) - TPs (H&W) failed to maintain adequate records and properly substantiate their income and expenses	No	IRS
Woodsum v. Comm'r, 136 T.C. 585 (2011)	6662(b)(2) - TPs (H&W) failed to include $3.4 million of income, even though they provided all (160) relevant information returns to tax preparer; TPs failed to show reasonable cause in relying on tax preparer, as the unexplained omission did not constitute "advice" to exclude the item and TPs did not fulfill their duty to review the prepared return for accuracy	No	IRS
Zurn v. Comm'r, T.C. Memo. 2012-132	6662(b)(1) - TP negligent for failing to substantiate purported like-kind exchanges	No	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, & Sole Proprietorships – Schedules (C, E, F)			
Alderman v. Comm'r, T.C. Memo. 2012-130	6662(b)(2) - TP substantially understated income and did not show reasonable cause or substantial authority	Yes	IRS
Alioto v. Comm'r, T.C. Memo. 2011-151, *appeal docketed*, No. 12-1201 (6th Cir. Feb. 23, 2012)	6662(b)(1) & (2) - TP acted with reasonable cause and made a good faith effort on the basis of his knowledge of the facts and understanding of the law in claiming losses	No	TP

Table 2: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Bailey v. Comm'r, T.C. Memo. 2012-96	6662(b)(1) - TP failed to show reasonable cause and good faith in failing to report income, and had no substantial authority for deductions claimed to which TP was not entitled	Yes	IRS
Barnes v. Comm'r, T.C. Memo. 2012-80, *appeal docketed*, No. 12-1284 (D.C.Cir. July 6, 2012)	6662(b)(2) - TPs (H&W) substantially understated tax liability and failed to show reasonable cause and good faith; there was no substantial authority for their position; they did not show a reasonable effort to accurately determine the tax liability; and could not show reliance on professional tax advice was reasonable	No	IRS
Bell v. Comm'r, T.C. Memo. 2011-296	6662(b)(2) - TP substantially understated income and failed to show reasonable cause or good faith; produced no records to substantiate his reported Schedule C expenses; failed to show from where Form 1040 numbers came; and could not show reliance on professional tax advice was reasonable	Yes	IRS
Bemont Invs, LLC v. U.S., 679 F.3d 339 (5th Cir. 2012), *aff'g* 106 A.F.T.R.2d (RIA) 5542 (E.D.Tex. 2010)	6662(b)(1) & (2) - TP's professional advisor "was no more than a 'puppet'" who "rendered no real independent or objective advice"	No	IRS
Blum v. Comm'r, T.C. Memo. 2012-16, *appeal docketed*, No. 12-9005 (10th Cir. July 16, 2012)	6662(b)(1) - TPs (H&W) were negligent for providing false misrepresentations to their professional tax preparers and for relying on advisors who were also promoters of the transaction	No	IRS
Bonds v. Comm'r, T.C. Summ. Op. 2011-122	6662(b)(1) - TP lacked substantiating evidence and failed to reasonably reconstruct destroyed essential records through secondary evidence	Yes	IRS
Bronson v. Comm'r, T.C. Memo. 2012-17, *appeal docketed*, No. 12-72342 (9th Cir. July 24, 2012)	6662(b)(2) - TPs (H&W) provided no evidence that they ever sought or received professional advice concerning the appropriateness of their disallowed deductions	Yes	IRS
Candyce Martin 1999 Irrevocable Trust v. U.S., 822 F. Supp. 2d 968 (N.D. Cal. 2011), *appeal docketed*, No. 11-17879 (9th Cir. Dec. 2, 2011)	6662(b)(1) & (2) - TPs' reliance on tax professional's advice not reasonable when advice not based on all relevant facts; TPs did not exercise due diligence in determining correctness of return position; TPs should have known that absence of tax liability on a sizeable capital gain did not reflect the economic reality of the transaction; and the underpayment of tax was not the result of an honest misunderstanding of fact or law.	No	IRS
Cantrell v. Comm'r, T.C. Summ. Op. 2012-28	6662(b)(1) & (2) - TP failed to substantiate expenses; reliance on tax return preparer was not reasonable	Yes	IRS
Cohan v. Comm'r, T.C. Memo. 2012-8	6662(b)(2) - TPs (3 H&W couples) reasonably relied on professional advice and were not liable for certain underpayments; but did not act with reasonable cause for failing to seek professional tax advice regarding the proper treatment of a charitable contribution deduction arising from a bargain sale gift	No	Split
D'Errico v. Comm'r, T.C. Memo. 2012-149	6662(b)(1) & (2) - TPs (corporation and sole shareholder) failed to produce adequate records or substantiate deductions, and did not argue reasonable cause	Yes	IRS
Diallo v. Comm'r, T.C. Memo. 2011-300	6662(b)(1) & (2) - TP failed to report gross receipts, keep adequate books and records, and substantiate items properly	Yes	IRS
Doris v. Comm'r, T.C. Summ. Op. 2011-111	6662(b)(1) & (2) - TP failed to substantiate Schedule A itemized deductions; deduction of expenses from a personal activity supports negligence penalty with respect to Schedule C deductions	Yes	IRS
Douglas v. Comm'r, T.C. Memo. 2011-214	6662(b)(2) - TPs (H&W) consulted with a competent tax adviser, provided proper information, and relied on advice in good faith	No	TP
Esgar Corp. v. Comm'r, T.C. Memo. 2012-35, *appeal docketed*, No. 12-9009 (10th Cir. Sept. 11, 2012)	6662(b)(2) - TPs used a competent tax professional, provided all relevant information, and relied on that advice in good faith	No	TP
Esrig v. Comm'r, T.C. Memo. 2012-38	6662(b)(1) - TPs (H&W) negligent for failing to keep adequate books and records; reliance on tax return preparer not credible	Yes	IRS
Faust v. Comm'r, T.C. Memo. 2011-158	6662(b)(1) - TPs (H&W) negligent for taking substantial disallowed deductions and showed no reasonable cause for their underpayment or that they acted in good faith in preparing their returns	Yes	IRS
Flores v. Comm'r, T.C. Summ. Op. 2011-112	6662(b)(1) - TPs (H&W) did not act in good faith or with reasonable cause in failing to substantiate thousands of dollars of expenses	Yes	IRS
Gaitan v. Comm'r, T.C. Memo. 2012-3	6662(b)(1) - TPs (H&W) negligent for not maintaining adequate records of their clothing-export business	No	IRS
Garavaglia v. Comm'r, T.C. Memo. 2011-228, *appeal docketed*, No. 12-1444 (6th Cir. Apr. 13, 2012)	6662(b)(2) - TP (H) subject to fraud penalty under § 6663, so imposition of the accuracy-related penalty on TP (W) would constitute improper stacking	No	TP

Appendix Three

Table 2: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Garcia v. Comm'r, T.C. Memo. 2012-155	6662(b)(2) - TP (H) subject to fraud penalty under § 6663, so imposition of the accuracy-related penalty on TP (W) would constitute improper stacking	No	TP
Goyak v. Comm'r, T.C. Memo. 2012-13	6662(b)(1) - TPs (H&W) negligent for not making a reasonable attempt to comply with the Code and for unreasonably relying on unqualified advisors	No	IRS
Greenwald v. Comm'r, T.C. Memo. 2011-239	6662(b)(1) & (2) - TP showed good faith reliance on professional tax advice	No	TP
Hall v. Comm'r, T.C. Summ. Op. 2012-48	6662(b)(1) - TPs (H&W) showed reasonable cause for mortgage interest and certain property-related deductions, but were not entitled to relief for underpayment due to "bad debt" deduction	Yes	Split
Hand v. Comm'r, T.C. Summ. Op. 2012-1	6662(b)(1) - Given TPs' (H&W) experience, knowledge, and education, testimony that they did not know they needed to keep adequate records or properly substantiate expenses was unconvincing and indicated a lack of reasonable cause and good faith	No	IRS
Healthpoint, Ltd. v. Comm'r, T.C. Memo. 2011-241	6662(b)(1) & (2) - TP did not adequately disclose position taken on settlement allocation; did not show substantial authority for positions; and did not show reasonable reliance on tax counsel	No	IRS
Heritage Org., LLC v. Comm'r, T.C. Memo. 2011-246	6662(b)(1) - TP did not investigate the proper treatment of certain research & development expenses; reliance on tax preparation firm not a defense because firm only prepared return, did not provide any advice	No	IRS
Hielsberg v. Comm'r, T.C. Summ. Op. 2012-36	6662(b)(1) & (2) - TP failed to substantiate claimed deductions and failed to establish that he acted in good faith or with reasonable cause by not providing tax return preparer complete and accurate information	Yes	IRS
Hyche v. Comm'r, T.C. Summ. Op. 2012-23	6662(b)(1) & (2) - TPs (H&W) showed reasonable basis and good faith for some of H's business-related deductions, but not others	Yes	Split
Kirkpatrick v. Comm'r, T.C. Summ. Op. 2011-123	6662(b)(2) - TPs (H&W) substantially understated income and did not provide any evidence that they acted with reasonable cause or good faith	Yes	IRS
Kirman v. Comm'r, T.C. Memo. 2011-128	6662(b)(1) & (2) - TPs unreasonably relied on unqualified tax preparer; did not provide all necessary information; and failed to review prepared return	No	IRS
LaFlamme v. Comm'r, T.C. Memo. 2012-36	6662(b)(1) - TP acted in good faith and had reasonable cause for the position taken	Yes	TP
Leak v. Comm'r, T.C. Summ. Op. 2012-39	6662(b)(1) & (2) - TP met reasonable cause and good faith exception for Schedule C deductions; but not for unreported income and charitable contributions	Yes	Split
Linzy v. Comm'r, T.C. Memo. 2011-264	6662(b)(1) & (2) - TP, an experienced tax return preparer, failed to keep adequate books and records to substantiate several claimed deductions and improperly deducted the cost of numerous items instead of depreciating them as required by law	Yes	IRS
Manalo v. Comm'r, T.C. Summ. Op. 2012-30	6662(b)(2) - TPs (H&W) failed to establish sufficient documentation to meet "material participation" standard related to rental property activity, so court sustained those disallowed losses; TPs did satisfy "active participation" test, which entitled them to more limited deductions; court sustained § 6662 penalty as to conceded items, but disallowed penalty for underpayment attributable to certain real estate losses to which TPs reasonably believed they were entitled	No	Split
Martignon v. Comm'r, T.C. Summ. Op. 2012-18	6662(b)(2) - TP made several attempts to access partnership's records and had his return prepared by an accountant in good-faith attempt to properly assess tax liability	Yes	TP
Martin, Estate of v. Comm'r, 438 Fed. Appx. 566 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-208	6662(b)(1) & (2) - TPs (W & Estate of H) did not act with reasonable cause or in good faith given the education and expertise of W as a retired accounting teacher; TPs failed to maintain receipts for expenses and failed to report arbitration award	No	IRS
McLauchlan v. Comm'r, T.C. Memo. 2011-289, *appeal docketed*, No. 12-60657 (5th Cir. Aug. 20, 2012)	6662(b)(2) - TP did not act with reasonable cause or in good faith with respect to any portion of underpayment; TP is well-educated attorney who prepared his own returns but failed to seek assistance of tax professional despite admitted difficulty preparing returns	No	IRS
Moore v. Comm'r, T.C. Summ. Op. 2012-16	6662(b)(1) - TPs (H&W) negligent for failing to substantiate many claimed deductions	Yes	IRS
Mulcahy, Pauritsch, Salvador & Co. v. Comm'r, 680 F.3d 867 (7th Cir. 2012), *aff'g* T.C. Memo. 2011-74	6662(b)(2) - TPs were not reasonable or acting in good faith since the CPA firm was taking tax advice from itself	No	IRS

Table 2: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Murray v. Comm'r, T.C. Summ. Op. 2012-49	6662(b)(1) & (2) - TP reasonably relied upon CPA and had reasonable cause for the underpayment of tax	No	TP
Olmstead v. Comm'r, T.C. Summ. Op. 2011-118	6662(b)(1) & (2) - TPs (H&W) did not act with reasonable cause because they made no attempt to assess their proper tax liability	Yes	IRS
Ong. v. Comm'r, T.C. Memo. 2012-114	6662(b)(2) - TP failed to establish accuracy of information provided to tax return preparer	Yes	IRS
Onyekwena v. Comm'r, T.C. Summ. Op. 2012-37	6662(b)(2) - Despite being a professional tax preparer, TP offered no evidence showing he acted with reasonable cause or in good faith when preparing his own return	Yes	IRS
Oros v. Comm'r, T.C. Memo. 2012-4, *appeal docketed*, No. 12-71071 (9th Cir. Apr. 9, 2012)	6662(b)(1) & (2) - TP reasonably relied upon experienced return preparer's advice in claiming deductions on Schedule C	Yes	TP
Ortega v. Comm'r, T.C. Memo. 2011-179	6662(b)(1) - TPs' (H&W) underpayment negligent and lacking in good faith or reasonable cause; TPs managed accounting and bookkeeping carelessly; failed to keep contemporaneous records; and failed to substantiate disputed deductions	Yes	IRS
Owen v. Comm'r, T.C. Memo. 2012-21	6662(b)(1) & (2) - TPs (H&W) did not provide tax professionals with accurate information and did not act reasonably or in good faith by relying on the advice	No	IRS
Parsons v. Comm'r, T.C. Memo. 2012-134	6662(b)(1) & (2) - TPs (H&W) failed to show reasonable cause or credible evidence for their erroneous deductions and failed to seek competent tax advice	Yes	IRS
Payan v. Comm'r, T.C. Summ. Op. 2011-80	6662(b)(2) - TPs (H&W) failed to show reasonable cause and good faith for failing to report income on Schedules C & E. Even if accountant had all necessary documentation, they signed return without review	Yes	IRS
Ramig v. Comm'r, T.C. Memo. 2011-147, *aff'd*, 2012 WL 5351261 (9th Cir. Oct. 24, 2012)	6662(b)(1) - TPs (H&W) negligent for having unlicensed bookkeeper prepare returns and making no effort to verify returns complied with internal revenue laws	No	IRS
Rinehart v. Comm'r, T.C. Memo. 2012-112	6662(b)(1) & (2) - TP failed to maintain adequate books and records and offered no arguments as to why his positions were reasonable or taken in good faith	Yes	IRS
Roumi v. Comm'r, T.C. Memo. 2012-2	6662(b)(1) & (2) - TP failed to reconstruct tax records that were allegedly destroyed; did not substantiate his claimed deductions or show reasonable cause or good faith for his underpayment	Yes	IRS
Rovakat, LLC v. Comm'r, T.C. Memo. 2011-225, *appeal docketed*, No. 12-1779 (3d Cir. Mar. 26, 2012)	6662(b)(1) & (2) - TP was not reasonable in relying on tax preparer who was also promoting the transaction and for relying on opinion containing material misinformation	No	IRS
Ryberg v. Comm'r, T.C. Summ. Op. 2012-24	6662(b)(1) - TPs (H&W) did not meet their burden of showing reasonable cause and good faith by merely claiming they consulted a tax return preparer	No	IRS
Samarasomgje v. Comm'r, T.C. Memo. 2012-23	6662(b)(1) - TPs (H&W) relied on same CPA for over 20 years and reasonably relied in good faith on his advice and judgment	No	TP
Seven W. Enters. v. Comm'r, 136 T.C. 539 (2011), *appeal docketed*, No. 12-2099 (7th Cir. May 4, 2012)	6662(b)(2) - With the exception of one return, TPs were not entitled to rely on an accountant who acted on behalf of TPs and was not independent from them	No	Split
Southgate Master Fund, LLC v. U.S., 659 F.3d 466 (5th Cir. 2011), *aff'g* 651 F. Supp. 2d 596 (N.D. Tex. 2009)	6662(b)(1) & (2) - TP showed reasonable cause and good faith for relying on advice of tax advisors regarding the tax positions that resulted in the underpayments of tax	No	TP
Sucilla v. Comm'r, T.C. Memo. 2011-197	6662(b)(2) - TP acted with reasonable cause and in good faith in relying on CPA to prepare tax returns	Yes	TP
Sun v. Comm'r, T.C. Summ. Op. 2011-107	6662(b)(1) & (2) - TPs' (H&W) negligent for failing to keep books and records and in failing to substantiate deductions; reliance on tax professional was unreasonable because they sought advice only on establishing a business, not deductibility of expenses	No	IRS
Swanson v. Comm'r, 438 Fed. Appx. 582 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-265	6662(b)(2) - TPs (H&W) did not carry their burden of proving they acted with due care in setting up a trust and calculating their tax liability	No	IRS
TIFD III-E, Inc. v. U.S., 666 F.3d 836 (2d Cir. 2012), *rev'g* 660 F. Supp. 2d 367 (D. Conn. 2009)	6662(b)(2) - TP failed to point to substantial authority supporting its tax position resulting in substantial understatement of income	No	IRS
Todd v. Comm'r, T.C. Memo. 2011-123, *aff'd*, 2012 WL 3530259 (5th Cir. Aug. 16, 2012)	6662(b)(1) & (2) - TPs' (H&W) reliance on tax advice was unreasonable because tax preparer did not have necessary expertise in employee benefit plans; TPs failed to show they provided preparer with all necessary and accurate information	No	IRS

Appendix Three

Table 2: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Vandergrift v. Comm'r, T.C. Memo. 2012-14	6662(b)(1) & (2) - TPs (H&W) reasonably relied on return preparer for underpayment, but errors in reporting overstated basis and expenses in TP's real estate business were the fault of TP, so those penalties upheld	No	Split
Vincentini v. Comm'r, 429 Fed. Appx. 560 (6th Cir. 2011), *aff'g* T.C. Memo. 2008-271	6662(b)(2) - TP's reliance on CPA was unreasonable; TP put his faith in a biased professional, affiliated with the organization promoting the fraudulent investments, and did not question CPA's professional background	No	IRS
Walker v. Comm'r, T.C. Memo. 2012-5	6662(b)(1) & (2) - TPs (H&W) negligent for failing to report income; claiming unsubstantiated deductions; and failing to make a reasonable attempt to comply with Code provisions	Yes	IRS
Ward v. Comm'r, T.C. Summ. Op. 2011-67	6662(b)(1) & (2) - TPs (H&W) conceded they were not entitled to any portion of rent/lease expense reported on their Schedule C, so accuracy-related penalty applied to that portion of underpayment; because Notice of Deficiency did not list any other adjustments, no penalty could be applied to other underpayments	Yes	Split
West v. Comm'r, T.C. Memo. 2012-148	6662(b)(1) - TP negligent for failing to maintain or produce books and records with respect to business activities	Yes	IRS
White v. Comm'r, T.C. Memo. 2012-104	6662(b)(1) & (2) - TPs (H&W) did not act with reasonable cause and in good faith in deducting contributions to welfare benefit fund by relying primarily upon advice of promoters and other interested parties that stood to benefit financially from the transaction	No	IRS
Wickersham v. Comm'r, T.C. Memo. 2011-178	6662(b)(1) & (2) - TPs (H&W) chose a competent advisor, provided all necessary information and relied in good faith on the advice	No	TP
Williams v. Comm'r, T.C. Memo. 2011-227	6662(b)(1) & (2) - TPs (H&W) negligent for not keeping adequate books or records of Schedule C business and for "guessing" on reported amounts of gross receipts and commission expenses	Yes	IRS
Wuerth v. Comm'r, T.C. Summ. Op. 2011-121	6662(b)(1) & (2) - TPs (H&W) claimed a casualty loss, but did not use a professional appraiser to determine property's fair market value before and after tornado; TPs' own estimate was unreasonable; and TPs' concession that they were not entitled to other deductions showed a lack of a reasonable attempt to comply with the law	Yes	IRS
Zatz v. Comm'r, T.C. Summ. Op. 2011-94	6662(b)(1) & (2) - TPs' (H&W) reliance on tax professionals was not reasonable because one advisor had a conflict or interest and another tax preparer was not provided complete and accurate information	No	IRS
Zeluck v. Comm'r, T.C. Memo. 2012-98	6662(b)(1) - TP negligent in failing to recognize gain on amount of note obligation when it became non-genuine; no substantial authority for the position taken	No	IRS
Zweifel v. Comm'r, T.C. Memo. 2012-93	6662(b)(1) & (2) - TPs' failure to timely file demonstrates that they did not act in good faith or with reasonable cause	No	IRS

Table 3 Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)				
Ahmad v. Comm'r, T.C. Memo. 2011-269	Lien/Levy	TPs (H&W) precluded from challenging underlying liability; no abuse of discretion	Yes	IRS
Akonji v. Comm'r, T.C. Memo. 2012-56	Lien	No abuse of discretion	Yes	IRS
Alexander v. Comm'r, T.C. Memo. 2012-75	Lien	Challenge to underlying frivolous return penalties; penalties upheld	Yes	IRS
Amesquita v. Comm'r, 430 Fed. Appx. 690 (10th Cir. 2011)	Lien	No abuse of discretion; failure to raise issue in Tax Court bar to further litigation	Yes	IRS
Anderson v. Comm'r, T.C. Memo. 2012-46	Levy	Denied partial summary judgment with respect to underlying frivolous return penalties but found no abuse of discretion with respect to remaining issues	Yes	IRS
Balsamo v. Comm'r, T.C. Memo. 2012-109	Lien	No abuse of discretion in rejecting offer	Yes	IRS
Barnes v. Comm'r, T.C. Memo. 2011-168	Levy	No abuse of discretion	Yes	IRS
Barry v. Comm'r, T.C. Memo. 2011-127	Lien/Levy	No abuse of discretion in denying face-to-face hearing	Yes	IRS
Bell v. Comm'r, T.C. Summ. Op. 2012-45	Levy	TPs (H&W) precluded from challenging underlying tax liability; no abuse of discretion in denying face-to-face hearing or rejecting offer	Yes	IRS
Black v. Comm'r, T.C. Summ. Op. 2011-69	Lien	No abuse of discretion in sustaining lien filing or denying installment agreement	Yes	IRS
Blackburn v. Comm'r, T.C. Summ. Op. 2012-4	Levy	Challenge to underlying liability	Yes	IRS
Blumenthal v. Comm'r, T.C. Summ. Op. 2011-81	Lien	No abuse of discretion; prior refund barred by statute of limitations	Yes	IRS
Busche v. Comm'r, T.C. Memo. 2011-285	Levy	No abuse of discretion in denying face-to-face hearing	Yes	IRS
Byers v. Comm'r, T.C. Memo. 2012-27, *appeal docketed*, No. 12-1351 (D.C. Cir. Aug. 10, 2012)	Levy	No abuse of discretion	Yes	IRS
Byrd v. Comm'r, T.C. Memo. 2011-146, *appeal dismissed*, No. 11-2104 (6th Cir. Oct. 4, 2011)	Lien/Levy	No abuse of discretion; TPs (H&W) assessed section 6673 penalty for making frivolous arguments	Yes	IRS
Campbell v. Comm'r, T.C. Memo. 2012-82	Levy	Summary judgment concerning challenge to underlying liability denied; case set for trial	Yes	Not applicable
Carlson v. Comm'r, T.C. Memo. 2012-76, *appeal docketed*, No. 12-72030 (9th Cir. June 26, 2012)	Lien/Levy	Challenge to underlying liability; liability sustained; no abuse of discretion with respect to remaining issues	Yes	IRS
Churchill v. Comm'r, T.C. Memo. 2011-182	Lien/Levy	No abuse of discretion in rejecting OIC; remand for change of circumstances from original determination	Yes	IRS
Ciafre v. Comm'r, T.C. Summ. Op. 2011-124	Lien	No abuse of discretion in rejecting collection alternatives	Yes	IRS
Coleman v. Comm'r, 420 Fed. Appx. 663 (8th Cir. 2011), *aff'g* T.C. Memo. 2010-51	Lien/Levy	No abuse of discretion in rejecting collection alternatives for failure to timely provide financial information	Yes	IRS
Coleman v. Comm'r, T.C. Memo. 2012-116, *appeal docketed*, Nos. 12-72482 and 12-72483 (9th Cir. Aug. 6, 2012)	Levy	No abuse of discretion in rejecting request for interest abatement due to ministerial act	No	IRS
Colvin v. Comm'r, 460 Fed. Appx. 349 (5th Cir. 2012), *aff'g* T.C. Memo. 2010-235	Levy	Challenge to underlying liability based on bankruptcy discharge	Yes	IRS
Conn v. Comm'r, T.C. Memo. 2011-166	Lien/Levy	No abuse of discretion; prior refund barred by statute of limitations	No	IRS
Conway v. Comm'r, 137 T.C. 209 (2011), *appeal docketed*, No. 12-70992 (9th Cir. Mar. 30, 2012)	Lien/Levy	No abuse of discretion in levy action; lien filing premature due to failure to provide notice and demand for payment	No	Split
Crain v. Comm'r, T.C. Memo. 2012-97, *appeal dismissed*, No. 12-9004 (10th Cir. Oct. 25, 2012)	Lien/Levy	TP precluded from challenging underlying tax liability; no abuse of discretion in denying face-to-face hearing	Yes	IRS
D'Arcy v. Comm'r, T.C. Memo. 2011-213	Levy	TP precluded from challenging underlying tax liability; no abuse of discretion	Yes	IRS
Delano v. Comm'r, T.C. Summ. Op. 2011-105	Levy	No abuse of discretion in rejecting OIC	Yes	IRS

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Table 3: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Delgado v. Comm'r, T.C. Memo. 2011-240	Lien	No abuse of discretion	No	IRS
DeLon v. Comm'r, T.C. Memo. 2012-33, *appeal docketed*, No. 12-1792 (4th Cir. June 26, 2012)	Levy	TP precluded from challenging underlying tax liability; no abuse of discretion	Yes	IRS
Devlin v. Comm'r, T.C. Memo. 2012-145	Lien	Challenge to underlying tax liability; no abuse of discretion	Yes	IRS
Diamond v. Comm'r, T.C. Memo. 2012-90, *appeal dismissed*, No. 12-2493 (8th Cir. Aug. 9, 2012)	Lien/Levy	TP precluded from challenging underlying tax liability; no abuse of discretion in denying face-to-face hearing	Yes	IRS
Diemer v. Comm'r, 448 Fed. Appx. 385 (4th Cir. 2011)	Levy	No abuse of discretion in rejecting frivolous arguments	Yes	IRS
Dingman v. Comm'r, T.C. Memo. 2011-116,	Levy	Penalty assessments untimely; proposed collection action not sustained	Yes	TP
Dominguez v. Comm'r, T.C. Memo. 2011-281	Levy	No abuse of discretion	Yes	IRS
Doose v. Comm'r, 457 Fed. Appx. 632 (9th Cir. 2011), *aff'g* T.C. Memo. 2010-18	Levy	No abuse of discretion	Yes	IRS
Farhoumand v. Comm'r, T.C. Memo. 2012-131	Levy	Challenge to underlying liability; liability sustained; no abuse of discretion found for all remaining issues	No	IRS
Fatehi v. Comm'r, T.C. Summ. Op. 2012-26	Lien	Abuse of discretion in rejecting offer	Yes	TP
Gillum v. Comm'r, 676 F.3d 633 (8th Cir. 2012), *aff'g* T.C. Memo. 2010-280	Lien/Levy	No abuse of discretion in rejecting offer; Tax Court lacked jurisdiction to review IRS letters to TP's alter egos and nominees	No	IRS
Gonzalez v. Comm'r, T.C. Memo. 2012-151	Lien	TP precluded from challenging underlying tax liabilities; no abuse of discretion	Yes	IRS
Gossage v. Comm'r, 444 Fed. Appx. 326 (11th Cir. 2011)	Levy	TP precluded from challenging underlying tax liability	Yes	IRS
Gowen v. Comm'r, T.C. Memo. 2012-40	Lien	TP precluded from challenging underlying tax liability	Yes	IRS
Gravette v. Comm'r, T.C. Memo. 2011-138	Levy	No abuse of discretion in rejecting offer	Yes	IRS
Gray v. Comm'r, 138 T.C. No. 13 (2012), *appeal docketed*, Nos. 12-2574 and 12-2575 (7th Cir. July 3, 2012)	Lien/Levy	Lack of jurisdiction	Yes	IRS
Hawaii v. Comm'r, T.C. Memo. 2011-134	Levy	No abuse of discretion in denying streamlined installment agreement	No	IRS
Hughes v. Comm'r, T.C. Memo. 2011-294	Lien	No abuse of discretion	Yes	IRS
Hughes v. Comm'r, T.C. Memo. 2012-42	Lien	Lack of jurisdiction because petition untimely	No	IRS
Jackson v. Comm'r, T.C. Memo. 2012-58	Lien/Levy	No abuse of discretion; TP assessed section 6673 penalty for making frivolous arguments	Yes	IRS
Johnson v. Comm'r, T.C. Summ. Op. 2011-100	Levy	TP precluded from challenging underlying tax liabilities; no abuse of discretion	Yes	IRS
Jordan v. Comm'r, T.C. Memo. 2011-243	Lien	TP precluded from challenging underlying tax liability	No	IRS
Joy v. Comm'r, 437 Fed. Appx. 537 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-197	Levy	Lack of jurisdiction	Yes	IRS
Kamps v. Comm'r, T.C. Memo. 2011-287	Levy	TP precluded from challenging underlying tax liabilities; no abuse of discretion in denying face-to-face hearing	Yes	IRS
Karakaedos v. Comm'r, T.C. Memo. 2012-53	Lien	No abuse of discretion in declining reinstatement or reissuance of installment agreement; installment agreement did not require lien withdrawal; abuse of discretion for failure to abate fees	Yes	Split
Kerpsie v. Comm'r, 457 Fed. Appx. 644 (9th Cir. 2011)	Lien	Appellate court found that because TP's failed to contest government's summary judgment motion, he waived right to appeal	Yes	IRS
Klingenberg v. Comm'r, T.C. Memo. 2011-247, *appeal docketed,* No. 12-70441 (9th Cir. Feb. 13, 2012)	Lien	No abuse of discretion in denying face-to-face hearing and rejecting offer	No	IRS
Kobs v. Comm'r, T.C. Memo. 2012-37	Levy	No abuse of discretion	Yes	IRS
Kurtz v. Comm'r, T.C. Memo. 2011-169	Levy	No abuse of discretion	No	IRS
Kurtz v. Comm'r, T.C. Memo. 2011-170	Levy	No abuse of discretion	No	IRS

Table 3: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Kurtz v. Comm'r, T.C. Memo. 2011-171	Levy	No abuse of discretion	No	IRS
Lampf v. Comm'r, T.C. Memo. 2011-282	Levy	No abuse of discretion in rejecting offer	Yes	IRS
Layton v. Comm'r, T.C. Memo. 2011-194	Levy	No abuse of discretion in rejecting offer	Yes	IRS
Lee v. Comm'r, 463 Fed. Appx. 236 (5th Cir. 2012)	Levy	Appellate court upheld penalties assessed under IRC §§ 6702 and 6673	Yes	IRS
Leshin v. Comm'r, 436 Fed. Appx. 791 (9th Cir. 2011)	Lien	No abuse of discretion in rejecting offer	No	IRS
Lewis v. Comm'r, T.C. Memo. 2012-138	Levy	TP precluded from challenging underlying tax liabilities; abuse of discretion in sustaining levy without face-to-face hearing or review of TP's financial information	Yes	Split
Litwak v. Comm'r, 109 A.F.T.R.2d (RIA) 2270 (9th Cir. 2012), *aff'g* T.C. Memo. 2009-292	Levy	No abuse of discretion in rejecting offer	No	IRS
Mangiardi, Estate of v. Comm'r, 442 Fed. Appx. 526 (11th Cir. 2011), *aff'g* T.C. Memo. 2011-24	Levy	No abuse of discretion in rejecting offer	No	IRS
Marcinek v. Comm'r, 467 Fed. Appx. 153 (3rd Cir. 2012), *cert. denied*, 2012 WL 2050502 (2012)	Lien	No abuse of discretion in rejecting frivolous arguments	Yes	IRS
Mathia v. Comm'r, 669 F.3d 1080 (10th Cir. 2012), *aff'g* T.C. Memo. 2009-120	Levy	Appellate court upheld determination that assessments were timely	No	IRS
McLaine v. Comm'r, 138 T.C. No. 10 (2012)	Levy	No abuse of discretion in refusing to consider collection alternatives	No	IRS
McNeil v. Comm'r, 109 A.F.T.R.2d (RIA) 1341 (10th Cir. 2012)	Levy	No abuse of discretion in rejecting frivolous arguments	Yes	IRS
McNeil v. Comm'r, T.C. Memo. 2011-150, *aff'd*, 451 Fed. Appx. 622 (8th Cir. 2012)	Levy	Challenge to underlying frivolous return penalties; penalties sustained and no abuse of discretion	Yes	IRS
Nasir v. Comm'r, T.C. Memo. 2011-283	Lien	Challenge to underlying additions to tax; no abuse of discretion in rejecting offer	Yes	IRS
Pisetzner v. Comm'r, T.C. Memo. 2012-64	Levy	No abuse of discretion in rejecting collection alternatives	Yes	IRS
Pretscher v. Comm'r, 444 Fed. Appx. 985 (9th Cir. 2011)	Not stated	No abuse of discretion in denying face-to-face hearing	Yes	IRS
Reyes v. Comm'r, 449 Fed. Appx. 478 (6th Cir. 2011)	Levy	No abuse of discretion in rejecting collection alternatives	Yes	IRS
Rivas v. Comm'r, T.C. Memo. 2012-20, *appeal docketed*, No. 12-1793 (2nd Cir. Apr. 30, 2012)	Levy	TP precluded from challenging underlying liability; no abuse of discretion in denying face-to-face hearing	Yes	IRS
Rosenbloom v. Comm'r, T.C. Memo. 2011-140	Levy	Abuse of discretion to uphold collection after expiration of statute of limitations; TP waiver invalid	No	TP
Salahuddin v. Comm'r, T.C. Memo. 2012-141	Levy	IRS motion for summary judgment denied; rejection of installment agreement was an abuse of discretion	Yes	TP
Sanchez v. Comm'r, T.C. Memo. 2011-149, *appeal dismissed*, No. 11-60739 (5th Cir. Nov. 29, 2011)	Lien	No abuse of discretion	Yes	IRS
Sandoval v. Comm'r, T.C. Memo. 2012-150	Levy	TP precluded from challenging underlying tax liabilities and net operating loss carryforwards due to prior judicial review	Yes	IRS
Seaver v. Comm'r, T.C. Memo. 2012-55, *appeal dismissed*, No. 12-1813 (7th Cir. May 17, 2012)	Levy	No abuse of discretion	Yes	IRS
Semen v. Comm'r, T.C. Memo. 2011-120	Levy	Challenge to underlying penalty for failure to pay; TPs (H&W) not liable for penalty due to reasonable cause; no abuse of discretion in putting the account in currently not collectible status	Yes	Split
Shebby v. Comm'r, T.C. Memo. 2011-125	Levy	No abuse of discretion in rejecting offer	No	IRS
Tinnerman v. Comm'r, 448 Fed. Appx. 73 (D.C. Cir. 2012), *aff'g* T.C. Memo. 2010-150	Levy	Appellate court affirmed the lower court finding of no abuse of discretion; upheld section 6673 penalties and imposed sanctions for pursing a frivolous appeal	No	IRS
Titsworth v. Comm'r, T.C. Memo. 2012-12	Levy	No abuse of discretion in rejecting offer	Yes	IRS
Tracy v. Comm'r, T.C. Summ. Op. 2011-88	Lien	No abuse of discretion	Yes	IRS

Appendix Three

Table 3: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Tucker v. Comm'r, 676 F.3d 1129 (D.C. Cir. 2012), *aff'g* T.C. Memo. 2011-67, *aff'g* 135 T.C. 114 (2010), *petition for cert. filed*, No. 12-49 (July 12, 2012)	Lien	Appeals Officers are not inferior officers who must be appointed in conformity with the Appointments Clause of the U.S. Constitution; no abuse of discretion	No	IRS
Tucker v. Comm'r, T.C. Memo. 2012-30, *appeal docketed*, No. 12-1368 (3rd Cir. Feb. 13, 2012)	Levy	No abuse of discretion	Yes	IRS
Umoren v. Comm'r, T.C. Memo. 2012-117	Lien	Challenge to underlying frivolous return penalties; penalties upheld; no abuse of discretion	Yes	IRS
Vanmali v. Comm'r, T.C. Memo. 2012-100	Levy	No abuse of discretion in rejecting OIC	No	IRS
Veneziano v. Comm'r, T.C. Memo. 2011-160	Lien/Levy	No abuse of discretion in rejecting OIC	Yes	IRS
Waring v. Comm'r, T.C. Memo. 2011-270	Levy	TP precluded from challenging underlying tax liabilities; no abuse of discretion in rejecting offer	Yes	IRS
Watchman v. Comm'r, T.C. Memo. 2012-113	Levy	Challenge to underlying interest and penalty due to waiver in installment agreement; harmless error rejecting doubt as to liability offer for failure to provide financial information	Yes	IRS
Weber v. Comm'r, 138 T.C. No. 18 (2012)	Levy	No abuse of discretion	No	IRS
Weybrew v. Comm'r, 451 Fed. Appx. 257 (4th Cir. 2011)	Levy	Appellate court affirmed the validity of the frivolous return penalty and the imposition of section 6673 penalties	Yes	IRS
Winters v. Comm'r, T.C. Memo. 2012-85	Lien	No abuse of discretion	Yes	IRS
Wright v. Comm'r, T.C. Memo. 2012-24	Lien	No abuse of discretion	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C,E,F)				
535 Ramona, Inc. v. Comm'r, 461 Fed. Appx. 567 (9th Cir. 2011), *aff'g* 135 T.C. 353 (2010)	Lien/Levy	No abuse of discretion	No	IRS
Beeler v. Comm'r, 434 Fed. Appx. 41 (2d Cir. 2011), *vacating and remanding* T.C. Memo. 2009-266	Levy	Appellate court vacated judgment and remanded case to Tax Court for clarification regarding why TP's Trust Fund Recovery Penalty was not satisfied	No	TP
Bland v. Comm'r, T.C. Memo. 2012-84, *appeal docketed*, No. 12-1696 (4th Cir. May 29, 2012)	Lien	TP precluded from challenging underlying tax liability; no abuse of discretion in sustaining lien filing	No	IRS
Child Adult Intervention Servs., Inc. v. Comm'r, T.C. Memo. 2012-94	Levy	Penalties upheld because TP failed to establish reasonable cause; no abuse of discretion	Yes	IRS
City Wide Transit, Inc. v. Comm'r, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2nd Cir. Mar. 14, 2012)	Levy	Assessments untimely because statute of limitations not extended by accountant's fraud; Appeals erred as a matter of law in allowing collection to proceed	No	TP
Concert Staging Servs., Inc. v. Comm'r, T.C. Memo. 2011-231	Levy	No abuse of discretion in holding a telephonic hearing	No	IRS
Custom Stairs & Trim, Ltd, Inc. v. Comm'r, T.C. Memo. 2011-155	Lien/Levy	Challenge to underlying tax penalties; court ordered abatement of penalties based on reasonable cause	Yes	TP
E.J. Harrison & Sons, Inc. v. Comm'r, T.C. Memo. 2011-157	Levy	No abuse of discretion	No	IRS
Everett Assocs., Inc. v. Comm'r, T.C. Memo. 2012-143	Levy	Challenge to underlying interest and penalties; abuse of discretion in failure to address discharge of penalties that accrued during bankruptcy case; collection activity with respect to interest on priority claim or penalties not sustained but collection activity with respect to all liabilities listed on the proof of claim sustained; no jurisdiction over refund claim	Yes	Split
Kreit Mech. Assocs., Inc. v. Comm'r, 137 T.C. 123 (2011)	Levy	No abuse of discretion in rejecting offer	No	IRS
Leago v. Comm'r, T.C. Memo. 2012-39	Levy	Brain tumor is special circumstance to consider in evaluating an effective tax administration offer based on economic hardship; remanded case because insufficient information to evaluate offer	Yes	TP
Moreira v. Comm'r, T.C. Summ. Op. 2011-93	Levy	Challenge to underlying employment taxes; TP liable for three out of four quarters of employment taxes; no abuse of discretion	No	Split

Table 3: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Morgan v. Comm'r, T.C. Memo. 2011-290	Levy	TP precluded from challenging underlying tax liabilities; no abuse of discretion	Yes	IRS
Pacific West Fin. & Ins. Co. v. Comm'r, T.C. Memo. 2011-143	Lien/Levy	No abuse of discretion; reasonable cause to abate failure to deposit penalties for after-the-fact determined employment tax liabilities	No	Split
Perrin v. Comm'r, T.C. Memo. 2012-22	Levy	TP precluded from challenging underlying tax liabilities; no abuse of discretion	Yes	IRS
Simone's Butterfly v. Comm'r, T.C. Memo. 2011-187, *appeal dismissed*, No. 11-1435 (D.C. Cir. Dec. 22, 2011)	Lien/Levy	No abuse of discretion	No	IRS
Specialty Staff, Inc. v. Comm'r, T.C. Memo. 2012-52	Lien/Levy	No abuse of discretion in rejecting collection alternatives	Yes	IRS
Thompson v. Comm'r, T.C. Memo. 2012-87	Levy	TP precluded from challenging underlying liability; no abuse of discretion in rejecting collection alternatives when TP fails to provide requested financial information	No	IRS
Tomasello v. Comm'r, T.C. Summ. Op. 2012-29	Levy	TP precluded from challenging underlying tax liabilities; no abuse of discretion	Yes	IRS
Tree-Tech, Inc. v. Comm'r, T.C. Memo. 2011-162	Levy	TP precluded from challenging underlying tax liabilities because TP had entered into a closing agreement; no abuse of discretion	Yes	IRS

Appendix Three

Table 4 Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Anderson v. Comm'r, T.C. Summ. Op. 2011-84	Deduction denied for newspapers during job search because expense was personal; deductions denied for unsubstantiated cell phone and automobile expenses	Yes	IRS
Anyanwu v. Comm'r, T.C. Summ. Op. 2011-74	Deductions denied for failure to substantiate internet, phone and computer expenses; deduction denied for travel for failure to show eligibility for employer reimbursement	Yes	IRS
Baker v. Comm'r, T.C. Summ. Op. 2011-95	Deductions denied for TPs' (H&W) travel to tax homes because expense was personal; deduction allowed for H's substantiated meals, but denied for incidental expenses in 2005 tax year; deduction denied for W's meals for failure to substantiate	No	Split
Blackburn v. Comm'r, T.C. Summ. Op. 2012-4	Deduction denied for unsubstantiated § 212 ordinary expenses incurred in production of income	Yes	IRS
Byers v. Comm'r, 420 Fed. Appx. 658 (8th Cir. 2011), *rev'g and remanding* T.C. Memo. 2007-331	Deduction allowed for truck lease payments and remanded to Tax Court for recomputation of deficiency	Yes	TP
Diaz v. Comm'r, T.C. Summ. Op. 2011-103	Deduction allowed for substantiated mileage expenses; deduction denied for clothing since it was adaptable to general use; deductions denied for unsubstantiated toll, cell phone, computer and other office expenses	Yes	Split
Doris v. Comm'r, T.C. Summ. Op. 2011-111	Deduction denied for uniform expenses because TP received uniform allowance in excess of his substantiated costs; deductions denied for self-defense classes and weapons expenses for failure to substantiate and to show required for employment; deductions denied for kart-racing activity because not engaged in for profit under § 183	Yes	IRS
Farias v. Comm'r, T.C. Memo. 2011-248	Deductions denied for education, travel, computer, clothing and other employee expenses for failure to substantiate and to prove ordinary and necessary in the course of employment	Yes	IRS
Faust v. Comm'r, T.C. Memo. 2011-158	Deductions denied because not engaged in for profit under § 183 and for failure to demonstrate carrying on a business under § 183; deductions denied for spouse's employee expenses for failure to prove ordinary and necessary in the course of employment	Yes	IRS
Glover v. Comm'r, T.C. Summ. Op. 2011-109	Deductions denied for TP employee travel, meal and lodging expenses from embarking and disembarking vessels in the New York City area tax home because expenses were personal	No	IRS
Gritz v. Comm'r, T.C. Summ. Op. 2012-20	Deduction denied for TP's mileage expenses from residence to company airfield because it was a personal expense; deduction denied for TP's other unsubstantiated employee expenses; deductions denied for spouse's employee expenses for failure to keep adequate records, failure to seek employer reimbursement and failure to prove expenses ordinary and necessary in the course of employment	Yes	IRS
Helguero-Balcells v. Comm'r, T.C. Summ. Op. 2012-31	Deduction allowed for educational travel that did not exceed one week to extent substantiated, but deduction denied for other educational travel because § 274(c) requirement not met; deductions allowed for business travel and some unreimbursed employee expenses; deductions denied for unsubstantiated job search and cell phone expenses; deduction denied for meals because they were personal	Yes	Split
Hielsberg v. Comm'r, T.C. Summ. Op. 2012-36	Deductions denied for unsubstantiated automobile, travel, cell phone and other expenses	Yes	IRS
Lyseng v. Comm'r, T.C. Memo. 2011-226	Deductions allowed for substantiated automobile expenses and some union dues; deductions denied for unsubstantiated employee expenses	No	Split
Nolder v. Comm'r, T.C. Summ. Op. 2012-50	Deductions allowed for substantiated employee expenses such as professional supplies, clothing and truck related expenses; deductions denied for cell phone and other unsubstantiated employee expenses; deduction also denied for misc. personal expenses, including meals and entertainment because they were personal	Yes	Split
Oros v. Comm'r, T.C. Memo. 2012-4, *appeal docketed*, No. 12-71071 (9th Cir. Apr. 9, 2012)	Deductions denied for travel and meal expenses for TP who took a world trip to write a book but failed to establish that his writing activity qualified as a trade or business within § 162(a)	Yes	IRS
Patel v. Comm'r, T.C. Memo. 2012-9	Deductions denied for unsubstantiated business loss deductions	Yes	IRS
Schramm v. Comm'r. T.C. Memo. 2011-212	TP found to be a common law employee (not a statutory employee) and thus, business expenses deductible on Sch A only to the extent they exceed 2% of TP's AGI	Yes	IRS

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Wright v. Comm'r, T.C. Summ. Op. 2011-125	Deductions denied for travel, lodging, meals, entertainment and misc. expenses for failure to show eligibility for employer reimbursement and TP's uncorroborated testimony rejected	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedule C, E, F)			
Adler v. Comm'r, 443 Fed. Appx. 736 (3d Cir. 2011), *aff'g* T.C. Memo. 2010-47, *cert. denied*, 132 S. Ct. 1911 (2012)	Deductions denied for unsubstantiated business losses from H's greenhouse activity and W's stamping activity	Yes	IRS
Alridge v. Comm'r, T.C. Summ. Op. 2011-96	Deductions denied for failure to maintain any books or records of business expenses and TP's uncorroborated testimony rejected	Yes	IRS
Bailey v. Comm'r, T.C. Memo. 2012-96	Deductions denied for yacht rental activity because not engaged in for profit under § 183; deductions allowed for development of prototype and research expenses for aviation business; deductions denied for unsubstantiated business expenses for law practice	Yes	Split
Barker v. Comm'r, T.C. Memo. 2012-77	Deductions denied for failure to prove carrying on a trade or business under § 183	No	IRS
Bell v. Comm'r, T.C. Memo. 2011-296	Deductions denied for most Sch C expenses for failure to substantiate due to loss of records and TP's uncorroborated testimony rejected; deductions allowed under *Cohan* for some operating expenses such as rental of machinery, equipment repairs and maintenance and gas	Yes	Split
Blake, U.S. v., 108 A.F.T.R.2d (RIA) 7437 (E.D. Mich. 2011)	Deductions denied for unsubstantiated business expenses and for failure to prove that other expenses were ordinary and necessary to business	No	IRS
Bogue v. Comm'r, T.C. Memo. 2011-164, *appeal docketed*, No. 12-1508 (3d Cir. Mar. 1, 2012)	Deductions denied for commuting expenses to worksites, because TP's residence not principal place of business under § 280A and temporary/regular work location exceptions do not apply; deductions denied for unsubstantiated transportation expenses, legal fees paid in prior years (cash basis TP) and office expenses because they were personal; deduction allowed for unreimbursed settlement payment related to business	Yes	Split
Bronson v. Comm'r, T.C. Memo. 2012-17, *appeal docketed*, Nos. 12-72342 and 12-72343 (9th Cir. July 24, 2012)	Deductions denied because not engaged in for profit under § 183	Yes	IRS
Broz v. Comm'r, 137 T.C. 46 (2011), *appeal docketed*, No. 12-1403 (6th Cir. Apr 6, 2012)	Deductions denied for beginning expenses for failure to establish active trade or business within § 162(a)	No	IRS
Bulas v. Comm'r, T.C. Memo. 2011-201	Deduction partially allowed for home office expense under § 280A(c) where space met exclusive business use requirement; deduction denied for unsubstantiated wages paid to daughters	Yes	Split
Burley v. Comm'r, T.C. Memo. 2011-262, *appeal docketed*, No. 12-1802 (6th Cir. June 20, 2012)	Deductions denied for automobile and truck expenses for failure to keep adequate records and TP and third-party testimonies rejected	No	IRS
Cibotti v. Comm'r, T.C. Summ. Op. 2012-21	Deductions allowed for gift cards ($25 per donee) to the extent substantiated; deduction allowed for some mileage expenses incurred due to departures from home office because proved ordinary and necessary in business	Yes	Split
Colvin v. Comm'r, T.C. Memo. 2012-26	Deductions denied for misc. Sch C expenses for failure to substantiate due to lost records and TP and expert testimonies rejected as unhelpful	No	IRS
Davis v. Comm'r, T.C. Memo. 2011-286, *appeal docketed*, No. 12-10916 (11th Cir. Feb. 23, 2012)	Deduction allowed for reasonable stock compensation paid by closely-held corp. because option was granted to secure consultant/stockholder's participation in management and option was negotiated at arm's length standard despite family relationship	No	TP
D'Errico v. Comm'r, T.C. Memo. 2012-149	Deductions denied for home office expenses for failure to establish that business was conducted at home; deductions denied for airplane leasing activity because not engaged in for profit under § 183; deductions denied for unsubstantiated automobile, meals, entertainment, cell phone, travel and other expenses	Yes	IRS
Diallo v. Comm'r, T.C. Memo. 2011-300	Deduction denied for automobile fuel expense, meals and other misc. personal expenses because they were personal	Yes	IRS
Douglas v. Comm'r, T.C. Memo. 2011-214	Deduction denied under § 179 for airplane expense because airplane was not used to conduct corporate business	No	IRS
Ekwenugo v. Comm'r, T.C. Memo. 2011-232	Deductions denied for Sch C expenses for failure to maintain any books or records of business expenses and TP's uncorroborated testimony rejected; not enough evidence to use *Cohan*	Yes	IRS

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Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Esrig v. Comm'r, T.C. Memo. 2012-38	Deductions denied for Sch E losses and unsubstantiated office expenses; deductions denied under §179 for home office expenses for failure to prove business use and TP's uncorroborated testimony rejected	Yes	IRS
Fein v. Comm'r, T.C. Memo. 2011-142, *appeal docketed*, No. 11-3760 (2d Cir. Sept. 20, 2011)	Deductions denied for unsubstantiated expenses and failure to prove business purpose	Yes	IRS
Fernandez v. Comm'r, T.C. Memo. 2011-216	Deductions denied for unsubstantiated automobile, travel, meal, entertainment, depreciation, insurance, legal and professional services; deductions allowed under *Cohan* for reasonable office expenses, rents and supplies; deductions denied for cell phone and bank charges for failure to prove business purpose	Yes	Split
Flores v. Comm'r, T.C. Summ. Op. 2011-112	Deductions denied for unsubstantiated automobile and truck expenses for failure to prove business use; deductions denied for meals and entertainment for failure to prove business purpose; deductions denied for unsubstantiated advertising and travel expenses	Yes	IRS
Fuhrman v. Comm'r, T.C. Memo. 2011-236	Deductions denied for unsubstantiated management fees for failure to prove ordinary and necessary in business and TP's uncorroborated testimony rejected	No	IRS
F.W. Servs., Inc. & Subs. v. Comm'r, 459 Fed. Appx. 389 (5th Cir. 2012), *aff'g* T.C. Memo. 2010-128	Deductions denied for payments made into reserve fund because not deductible insurance premiums under § 162(a)	No	IRS
Gaitan v. Comm'r, T.C. Memo. 2012-3	Deduction denied for COG for failure to keep adequate records; deduction denied for automobile and truck expenses for failure to substantiate; deduction denied for travel expenses because expenses were personal	No	IRS
Goyak v. Comm'r, T.C. Memo. 2012-13	Deduction denied for benefit plan expenses because they were personal	No	IRS
Gunn v. Comm'r, T.C. Summ. Op. 2011-133	Deductions allowed for unreimbursed postal expenses on Sch A; deductions denied for mileage on Sch A for failure to show eligibility for employer reimbursement; deduction denied for business loss deduction on Sch C because Sch C was a nullity; deductions allowed under *Cohan* for some supply and repair expenses on Sch E	Yes	Split
Hall v. Comm'r, T.C. Summ. Op. 2012-48	Deduction allowed for Sch E expenses; deductions denied for bad debt (uncollectible rents due) because corresponding rental income entry not included in the same year or in any prior taxable year	Yes	Split
Hand v. Comm'r, T.C. Summ. Op. 2012-1	Deductions denied for flight lessons for failure to prove ordinary and necessary in business	No	IRS
Henderson v. Comm'r, T.C. Memo. 2012-54	Deductions denied for failure to establish that activity qualified as a trade or business within § 162(a)	No	IRS
The Heritage Org., LLC v. Comm'r, T.C. Memo. 2011-246	Deductions denied for loan repayments for failure to prove business purpose and for failure to prove ordinary and necessary in business	No	IRS
Hyche v. Comm'r, T.C. Summ. Op. 2012-23	Deductions denied for mileage expenses and § 179 property for failure to substantiate and for failure to maintain adequate records	Yes	IRS
Kirkpatrick v. Comm'r, T.C. Summ. Op. 2011-123	Deductions denied for unsubstantiated education expense and for failure to prove business purpose for other expenses; deduction allowed for renewal of license	Yes	Split
Kirman v. Comm'r, T.C. Memo. 2011-128	Deductions denied for unsubstantiated travel expenses because TP's uncorroborated testimony was rejected; deductions denied for unsubstantiated advertising and insurance expenses; deductions allowed under *Cohan* for commissions and fees and some repair and maintenance expenses	No	Split
LaFlamme v. Comm'r, T.C. Memo. 2012-36	Deduction denied for pension contribution to self on Sch C, but deduction allowed on line 28, Self-employed SEP, SIMPLE, and qualified plans, of *Form 1040*	Yes	IRS
Langille v. Comm'r, 447 Fed. Appx. 130 (11th Cir. 2011), *aff'g* T.C. Memo. 2010-49	Deductions denied for failure to substantiate law practice expenses	Yes	IRS
Leak v. Comm'r, T.C. Summ. Op. 2012-39	Deduction denied for unsubstantiated automobile and truck expenses; deductions allowed under *Cohan* for some repair and maintenance and other expenses	Yes	Split
Linzy v. Comm'r, T.C. Memo. 2011-264	Deduction denied for contract labor for failure to keep adequate records; deductions allowed for mortgage interest, some repairs and maintenance and other expenses	Yes	Split
Loewenhagen v. Comm'r, T.C. Summ. Op. 2011-70	Deductions denied for expenses related to mobile home because they were personal; deductions allowed for qualified nonpersonal automobile expenses	Yes	Split

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Lua v. Comm'r, T.C. Memo. 2011-192	Deduction allowed for compensation paid to equipment installers	No	TP
Lubyanitskaya v. Comm'r, T.C. Memo. 2012-95	Deductions denied for unsubstantiated expenses	Yes	IRS
Lysford v. Comm'r, T.C. Memo. 2012-41	Deductions denied for airplane expenses for failure to show business use or recaptured §179 expenses	No	IRS
Mali v. Comm'r, T.C. Memo. 2011-121	Deductions allowed for various substantiated graphic design expenses; deductions denied for meals, entertainment, automobile, and cell phone expenses for failure to substantiate and for failure to prove business purpose	Yes	Split
Martin v. Comm'r, 438 Fed. Appx. 566 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-208	Deductions denied for unsubstantiated business expenses	No	IRS
McLauchlan v. Comm'r, T.C. Memo. 2011-289, *appeal docketed*, No. 12-60657 (5th Cir. Aug. 20, 2012)	Deductions denied for expenses for failure to seek reimbursement; deductions denied for unsubstantiated automobile expenses	No	IRS
Mobasher v. Comm'r, T.C. Summ. Op. 2012-14	Deductions denied for failure to establish that activity qualified as a trade or business within § 162(a)	Yes	IRS
Mondello v. Comm'r, T.C. Summ. Op. 2011-97	Deductions denied for contract labor expense	Yes	IRS
Moore v. Comm'r, T.C. Memo. 2011-173	Deductions denied for amount in excess of gambling losses for failure to prove professional gambler status	Yes	IRS
Moore v. Comm'r, T.C. Summ. Op. 2012-16	Deduction denied for unsubstantiated automobile and truck expenses for failure to keep adequate records and TPs' (H&W) uncorroborated testimonies rejected; deductions denied for one of the three Sch Cs for failure to establish activity qualified as a trade or business within § 162(a)	Yes	IRS
Morgan v. Comm'r, T.C. Summ. Op. 2011-92	Deductions allowed for substantiated cell phone and supply expenses; deduction denied for standard business mileage rate	Yes	Split
Mulcahy, Pauritsch, Salvador & Co., LTD. v. Comm'r, 680 F.3d 867 (7th Cir. 2012), *aff'g* T.C. Memo. 2011-74	Deductions denied for consulting fees because they were not compensation for services, but dividends	No	IRS
Murray v. Comm'r, T.C. Summ. Op. 2012-49	Deductions allowed to the extent substantiated as unreimbursed employee business expenses on Sch A; deductions denied for unsubstantiated automobile expenses and TP's uncorroborated testimony rejected	No	Split
Nordeen v. Comm'r, T.C. Summ. Op. 2011-104	Deductions denied for unsubstantiated expenses	Yes	IRS
Olagunju v. Comm'r, T.C. Memo. 2012-119	Deductions denied for automobile and truck expenses for failure to prove business purpose; deductions denied for unsubstantiated meals, entertainment, travel, utilities and other expenses; deductions partially allowed for office, advertising and wage expenses	Yes	Split
Ong v. Comm'r, T.C. Memo. 2012-114	Deductions denied for unsubstantiated travel, meals, entertainment, home office, legal and professional services, taxes and licenses, long-term health care insurance and other expenses; deduction allowed for contract labor	Yes	Split
Onyekwena v. Comm'r, T.C. Summ. Op. 2012-37	Deductions denied for unsubstantiated office and travel expenses; deductions denied for legal and professional fees based on TP's own testimony that business was not a § 162(a) going concern	Yes	IRS
Ortega v. Comm'r, T.C. Memo. 2011-179	Deductions denied for unsubstantiated travel, meal, entertainment, automobile and truck and cell phone expenses; deductions denied for cleaning and laundry expenses on Sch E due to passive loss rules; legal fees should be capitalized	Yes	IRS
Oser v. Comm'r, T.C. Summ. Op. 2012-19	Deductions denied for failure to substantiate and not enough evidence to use *Cohan*; deductions denied for unsubstantiated management, conservation and maintenance of property expenses	Yes	IRS
Payan v. Comm'r, T.C. Summ. Op. 2011-80	Deductions denied for unsubstantiated expenses and not enough evidence to use *Cohan*	Yes	IRS
Peimani v. Comm'r, T.C. Summ. Op. 2011-102	Deductions denied for unsubstantiated legal and professional services, house appraisals, telephone and automobile expenses	Yes	IRS
Plotkin v. Comm'r, T.C. Memo. 2011-260, *appeal docketed*, No. 12-10620 (11th Cir. Feb. 6, 2012)	Deductions denied for payments made to business associates and partner/ex-wife, legal fees and bank fees for failure to prove business purpose; deductions denied for unsubstantiated automobile repair expenses	No	IRS
Porch v. Comm'r, T.C. Summ. Op. 2012-25	Deductions denied for failure to substantiate	No	IRS

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Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Powerstein v. Comm'r, T.C. Memo. 2011-271	Deductions denied for legal fees for failure to substantiate and for failure to prove ordinary and necessary in business; deductions denied for farming expenses because not engaged in for profit under § 183 and for failure to demonstrate carrying on a business under § 183; deductions denied for home office expenses because TP's residence not principle place of business under § 280A	No	IRS
Ramig v. Comm'r, T.C. Memo. 2011-147, *aff'd*, No. 11-73898 (9th Cir. Oct. 24, 2012)	Deductions allowed for legal fees; deductions denied for credit card payments for failure to show genuine creditor-debtor relationship; deductions denied for other payments for failure to prove payments were loans	No	Split
Rios v. Comm'r, T.C. Memo. 2012-128, *appeal docketed*, No. 12-72440 (9th Cir. July 31, 2012)	Deductions denied for money transfers to third-party for failure to prove ordinary and necessary in business and for failure to substantiate	No	IRS
Roberts v. Comm'r, T.C. Summ. Op. 2011-127	Deductions allowed for travel because TP established home office under § 280A(c) and TP's testimony accepted as credible	No	TP
Rogers v. Comm'r, T.C. Memo. 2011-277, *appeal docketed*, No. 12-2652 (7th Cir. July 13, 2012)	Deductions allowed for legal and professional fees	No	TP
Roumi v. Comm'r, T.C. Memo. 2012-2	Deductions denied for unsubstantiated transportation, advertising and COG; deductions denied for one of three Sch Cs for failure to establish activity qualified as a trade or business within § 162(a)	Yes	IRS
Rundlett v. Comm'r, T.C. Memo. 2011-229	Deductions denied for stays at lavish hotels because expenses were personal	No	IRS
Rovakat, LLC v. Comm'r, T.C. Memo. 2011-225, *appeal docketed*, No. 12-1779 (3d Cir. Mar. 26, 2012)	Deductions denied for unsubstantiated business loss deductions for failure to establish partnership's basis and for failure to establish economic substance to the underlying transaction	No	IRS
Ryberg v. Comm'r, T.C. Summ. Op. 2012-24	Deductions allowed for horse breeding business losses to the extent substantiated; deductions denied for drag racing activity because not engaged in for profit under § 183	No	Split
Schoppe v. Comm'r, T.C. Memo. 2012-153, *appeal docketed*, No. 12-9010 (10th Cir. Sept. 12, 2012)	Deduction denied for failure to substantiate; not enough evidence to use *Cohan*	Yes	IRS
Scott v. Comm'r, T.C. Memo. 2012-65	Deductions denied for security deposit and advance rent because the first is not deductible until year forfeited, the second is apportioned over the lease term; deductions denied for credit card expenses because of duplication; deductions denied for unsubstantiated expenses	No	IRS
Settles v. U.S., 452 B.R. 637 (Bankr. E.D. Tenn. 2011)	IRS summary judgment motion granted because TP's promise to produce documentation substantiating deduction not sufficient to show genuine issue of material fact	No	IRS's Motion for Summary Judgment granted
Sherrer v. Comm'r, T.C. Memo. 2011-198	Deductions denied for failure to substantiate automobile and truck, travel, meals, entertainment, computer and other expenses; deductions allowed for some supply and repair and maintenance expenses	Yes	Split
Stahl v. U.S., 109 A.F.T.R.2d (RIA) 1507 (E.D. Wash. 2012), *appeal dismissed*, No. 12-35412 (9th Cir. June 8, 2012)	Deductions allowed for employee meals and medical expenses	No	TP (IRS Motion for Summary Judgment denied)
Strode v. Comm'r, T.C. Memo. 2012-59	Deductions denied for business loss deductions because not engaged in for profit under § 183	No	IRS
Sucilla v. Comm'r, T.C. Memo. 2011-197	Deductions denied for unsubstantiated expenses	Yes	IRS
Sun v. Comm'r, T.C. Summ. Op. 2011-107	Deductions allowed for legal and professional fees; deductions denied for automobile, travel, meals, entertainment and other expenses for failure to substantiate and for failure to prove ordinary and necessary in business; not enough evidence to use *Cohan*	No	Split
Swanson v. Comm'r, 438 Fed. Appx. 582 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-265	Tax Court did not err in determining trust was a sham and that some business expenses were personal	No	IRS

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Trupp v. Comm'r, T.C. Memo. 2012-108	Deductions allowed for storage and accounting expenses due to TP's credible testimony and adequate records; deduction denied for cell phone expenses for failure to show eligibility for employer reimbursement and for failure to substantiate; deduction denied for travel expenses for failure to prove business purpose; deductions denied for equestrian activities because not engaged in for profit under § 183	No	Split
Van der Lee v. Comm'r, T.C. Memo. 2011-234, *aff'd*, 2012 WL 5259141 (2d Cir. Oct. 25, 2012)	Deductions denied for business loss deductions for stock trading activity because TP not a trader; deductions denied for personal expenses and for unsubstantiated travel, meals and entertainment expenses	No	IRS
Van Wickler v. Comm'r, T.C. Memo. 2011-196	Deductions denied for horse breeding activity for failure to establish activity qualified as a trade or business within § 162(a); deductions denied under § 212 for lack of rational basis for amounts deducted	Yes	IRS
Ward v. Comm'r, T.C. Summ. Op. 2011-67	Deductions denied for automobile expense for failure to substantiate and for failure to prove business use	Yes	IRS
Weatherly v. Comm'r, T.C. Memo. 2011-206	Deductions denied for unsubstantiated contract labor expense; not enough evidence to use *Cohan*	Yes	IRS
Weller v. Comm'r, T.C. Memo. 2011-224	Deductions denied for unsubstantiated and unreimbursed employee business expenses in 2006 tax year	Yes	IRS
West v. Comm'r, T.C. Memo. 2011-272	Deductions denied for automobile depreciation because use was personal; deductions allowed for tractor depreciation; deductions allowed under *Cohan* for some farming and bricklaying expenses	Yes	Split
West v. Comm'r, T.C. Memo. 2012-148	Deductions denied for failure to substantiate Sch C expenses; not enough evidence to use *Cohan*	Yes	IRS
Westerman v. Comm'r, T.C. Memo. 2011-204	Deductions denied for unsubstantiated automobile and truck, travel, and other expenses; deductions allowed for repairs, rents paid and some supply expenses	Yes	Split
White v. Comm'r, T.C. Memo. 2012-104	Deductions denied for benefit-plan expenses because they were personal	No	IRS
Wilmot v. Comm'r, T.C. Memo. 2011-293	Deductions denied for photography business loss deductions because not engaged in for profit under § 183	Yes	IRS
Wilson v. Comm'r, T.C. Summ. Op. 2011-85	Deduction denied for automobile and truck expenses for failure to substantiate	Yes	IRS
Wolf v. Comm'r, T.C. Summ. Op. 2012-22	Deductions denied for Sch C travel expenses because they were personal commuting expenses and not eligible for employer reimbursement	Yes	IRS
Zenzen v. Comm'r, T.C. Memo. 2011-167	Deductions denied because not engaged in for profit under § 183	Yes	IRS
Zhang v. Comm'r, T.C. Memo. 2011-118	Deductions denied for website activity because not engaged in for profit under § 183, for failure to demonstrate carrying on a business under § 183 and TP's uncorroborated testimony rejected	Yes	IRS
Zweifel v. Comm'r, T.C. Memo. 2012-93	Deduction denied for payments into bondsman's "Build Up Fund" account (similar to a reserve account) because only deductible in year paid out to surety and not in year of deposit	No	IRS

Appendix Three

Table 5 Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But not Sole Proprietorships)			
Ahmed v. Comm'r, T.C. Memo. 2011-295, *appeal docketed*, No. 12-11337 (11th Cir. Mar. 5, 2012)	Settlement proceeds not excludable under IRC § 104(a)(2)	Yes	IRS
Bailey v. Comm'r, T.C. Memo. 2012-96	Use of misappropriated funds as collateral for loan excluded from income; unreported income from creditor payments made on TP's behalf	Yes	Split
Brashear v. Comm'r, T.C. Memo. 2012-136	Unreported retirement savings distribution	Yes	IRS
Brooks v. Comm'r, T.C. Memo. 2012-25	Unreported interest from discharge of indebtedness	No	IRS
Brown v. Comm'r, T.C. Memo. 2012-28	Unreported interest income from a settlement	Yes	IRS
Brown v. Comm'r, T.C. Summ. Op. 2012-5	Unreported interest from a state tax refund	Yes	IRS
Browning v. Comm'r, T.C. Memo. 2011-261	Unreported wages from an offshore employee leasing plan	No	IRS
Cahill v. Comm'r, T.C. Memo. 2011-203	Unreported interest and dividend income	No	IRS
Campbell v. Comm'r, 658 F.3d 1255, (11th Cir. 2011), *aff'g* 134 T.C. 20 (2010)	Unreported *qui tam* settlement income (*i.e.*, payment to a whistleblower for helping the government win a settlement)	No	IRS
Caton v. Comm'r, T.C. Memo. 2012-92	Unreported wages	Yes	IRS
Crane v. Comm'r, T.C. Memo. 2011-256	Arbitration award not excludable under IRC § 104(a)(2)	No	IRS
Dennis v. Comm'r, T.C. Summ. Op. 2011-134	Settlement proceeds not excludable under IRC § 104(a)(2); unreported wages	Yes	IRS
Driscoll, Comm'r v., 669 F.3d 1309 (11th Cir. 2012), *rev'g and remanding* 135 T.C. 557 (2010)	Parsonage allowance for second home not excludable under IRC § 107(2)	No	IRS
Enright v. Comm'r, 109 A.F.T.R.2d (RIA) 1146 (9th Cir. 2012), *aff'g* T.C. Docket No. 27955-08 (Jan. 25, 2010)	Settlement proceeds not excludable under IRC § 104(a)(2)	Yes	IRS
Esrig v. Comm'r, T.C. Memo. 2012-38	Unreported rental income	Yes	IRS
Feder v. Comm'r, T.C. Memo. 2012-10	Unreported life insurance proceeds deemed distribution	No	IRS
Felt v. Comm'r, 433 Fed. Appx. 293 (5th Cir. 2011), *aff'g* T.C. Memo. 2009-245	Unreported cancellation of debt income	No	IRS
Fernandez v. Comm'r, 138 T.C. No. 20 (2012)	Payments from spouse's disability pension received pursuant to a divorce agreement not excludable under IRC § 104(a)(1)	No	IRS
Garavaglia v. Comm'r, T.C. Memo. 2011-228, *appeal docketed*, No. 12-1438 (6th Cir. Apr. 13, 2012)	Unreported income from unlawful activities	No	IRS
Gutierrez v. Comm'r, T.C. Memo. 2011-263	Settlement proceeds not excludable under IRC § 104(a)(2)	Yes	IRS
Ham v. Comm'r, T.C. Summ. Op. 2012-3	Unreported mutual fund distributions mischaracterized as return of capital	Yes	IRS
Harrison v. Comm'r, 138 T.C. No. 17 (2012)	Wages not excludable under IRC § 893 or treaty	Yes	IRS
Hatch v. Comm'r, T.C. Memo. 2012-50, *appeal docketed*, No. 12-14133 (11th Cir. Aug. 4, 2012)	Unreported compensation for services	Yes	IRS
Henk v. Comm'r, T.C. Summ. Op. 2012-2	Unreported severance pay	Yes	IRS
Hudgins v. Comm'r, T.C. Summ. Op. 2012-10	Unreported unemployment compensation; IRS failed to meet burden of showing TP received entire amount reflected on Form 1099-G	Yes	Split
Hyde v. Comm'r, T.C. Memo. 2011-131	Unreported self-employment income	Yes	IRS
Juha v. Comm'r, T.C. Memo. 2012-68	Unreported dividend income	Yes	IRS
Kaider v. Comm'r, T.C. Memo. 2011-174	Bona fide loan proceeds not taxable	No	TP
Kay v. Comm'r, T.C. Memo. 2011-159, *appeal dismissed*, No. 11-73737 (9th Cir. Mar. 6, 2012)	Unreported state tax refund	Yes	IRS
Kleber v. Comm'r, T.C. Memo. 2011-233	Unreported cancellation of debt income	No	TP
Laue v. Comm'r, T.C. Memo. 2012-105	Unreported wages and nonemployee compensation	Yes	IRS

Table 5: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Lawrence v. Comm'r, 109 A.F.T.R.2d (RIA) 1437 (11th Cir. 2012), *aff'g* T.C. Docket No. 20370-09 (Jan. 5, 2011)	Unreported pension and social security income	Yes	IRS
Ledger v. Comm'r, T.C. Memo. 2011-183	Unreported life insurance policy dividends	Yes	IRS
LeTourneau v. Comm'r, T.C. Memo. 2012-45	Foreign earned income exclusion under IRC § 911	Yes	IRS
Levy v. Comm'r, T.C. Memo. 2012-133	Unreported dividend and other income	Yes	IRS
Liotti v. Comm'r, T.C. Summ. Op. 2011-73	Unreported cancellation of debt income	Yes	IRS
Martin v. Comm'r, 438 Fed. Appx. 566 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-208	Unreported arbitration award	Yes	IRS
McGowen v. Comm'r, 438 Fed. Appx. 686 (10th Cir. 2011), *aff'g* T.C. Memo. 2009-285	Unreported gain on life insurance policy termination	No	IRS
McGowen v. Comm'r, T.C. Memo. 2011-186	Settlement proceeds not excludable under IRC § 104(a)(2)	Yes	IRS
McNeil v. Comm'r, 467 Fed. Appx. 778 (10th Cir. 2012), *aff'g* T. C. Docket No. 18300-10 (June 14, 2011)	Unreported annuity income	Yes	IRS
McNeil v. Comm'r, 451 Fed. Appx. 622 (8th Cir. 2012), *aff'g* T.C. Memo. 2011-150	Unreported wages	Yes	IRS
Megibow v. Comm'r, T.C. Memo. 2011-211	Unreported interest income from overpayment (refund) of federal tax	No	IRS
Menefee v. Comm'r, T.C. Summ. Op. 2011-130	Unreported annuity death benefit	Yes	IRS
Neri v. Comm'r, T.C. Memo. 2012-71	Arbitration award not excludable under IRC § 104(a)(2)	No	IRS
Nipps v. Comm'r, T.C. Memo. 2011-267	Unreported social security income and proceeds from inherited retirement savings	Yes	IRS
Park v. Comm'r, 136 T.C. 569 (2011), *appeal docketed*, Nos. 12-1058 and 12-1059 (D.C. Cir. Jan. 13, 2012)	Interest and gambling income of nonresident alien not excludable under treaty	No	IRS
Parker v. Comm'r, T.C. Memo. 2012-66	Unreported wages and unemployment compensation	Yes	IRS
Perkins v. Comm'r, T.C. Memo. 2011-207	Unreported wages	Yes	IRS
Pierro v. Comm'r, 109 A.F.T.R.2d (RIA) 1299 (9th Cir. 2012), *aff'g* Tax Ct. Docket No. 18809-07	Payment to IRS on TP's behalf was income	Yes	IRS
Powerstein v. Comm'r, T.C. Memo. 2011-271	Unreported fees for services calculated by the net worth method	No	Split
Randolph v. Comm'r, T.C. Memo. 2012-125	Unreported interest income	Yes	TP
Ready v. Comm'r, T.C. Summ. Op. 2012-12	Foreign earned income exclusion under IRC § 911	Yes	IRS
Reesink v. Comm'r, T.C. Memo. 2012-118	Settlement proceeds not excludable under IRC § 104(a)(2), but unreported gain on sale excludable like-kind exchange under IRC § 1031	No	Split
Richmond v. Comm'r, T.C. Memo. 2011-251, *aff'd*, 474 Fed. Appx. 754 (10th Cir. 2012)	Unreported wages, interest, and trust income	Yes	IRS
Rios v. Comm'r, T.C. Memo. 2012-128, *appeal docketed*, No. 12-72440 (9th Cir. July 31, 2012)	Cancellation of debt income not excludable under IRC § 108(a)(1)(E)	No	IRS
Rogers v. Comm'r, T.C. Summ. Op. 2011-99	Unreported retirement annuity income	Yes	IRS
Ruffin v. Comm'r, T.C. Summ. Op. 2011-136	Settlement proceeds not excludable under IRC § 104(a)(2)	Yes	IRS
Sewards v. Comm'r, 138 T.C. No. 15 (2012), *appeal docketed*, No. 12-72985 (9th Cir. Sept. 18, 2012)	Disability pension payments not excludable under IRC § 104(a)(1)	No	IRS
Slingsby v. Comm'r, T.C. Memo. 2011-130	Unreported wages and dividend income	Yes	IRS
Stewart v. Comm'r, T.C. Summ. Op. 2012-46	Unreported cancellation of credit card debt income	Yes	TP
Todd v. Comm'r, T.C. Memo. 2011-123, *aff'd*, 2012 WL 3530259 (5th Cir. 2012)	Unreported distribution from an employee benefit fund	No	IRS
Wood v. Comm'r, T.C. Memo. 2011-190	Unreported income from embezzlement	No	IRS
Zurn v. Comm'r, T.C. Memo. 2012-132	No like-kind exchange under IRC § 1031	No	IRS

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Table 5: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)			
Akopian v. Comm'r, T.C. Memo. 2011-237	Unreported business income	No	IRS
Barnes v. Comm'r, T.C. Memo. 2012-80, *appeal docketed*, No. 12-1284 (D.C. Cir. July 6, 2012)	Allocation of gross receipts between TPs' (H&W) sole proprietorship and wholly-owned C corporation	No	IRS
Bosamia v. Comm'r, 661 F.3d 250 (5th Cir. 2011), *aff'g* T.C. Memo. 2010-218	Unreported income from disallowance of related party cost of goods sold under IRC § 267(a)(2)	No	IRS
Burley v. Comm'r, T.C. Memo. 2012-262, *appeal docketed*, No. 12-1802 (6th Cir. June 20, 2012)	Unreported Schedule C gross receipts determined under bank deposit analysis	No	IRS
Diallo v. Comm'r, T.C. Memo. 2011-300	Unreported business income determined under bank deposit analysis	Yes	IRS
Ekwenugo v. Comm'r, T.C. Memo. 2011-232	Unreported gross receipts under the bank deposits method	Yes	IRS
Gleason v. Comm'r, T.C. Memo. 2011-154	Unreported business income determined under bank deposit analysis	Yes	IRS
Kilker v. Comm'r, T.C. Memo. 2011-250	Unreported gain on sale of stock and fees for services	Yes	IRS
Kinsey v. Comm'r, T.C. Memo. 2011-257	Unreported income from discharge of obligation	No	Split
Lain v. Comm'r, T.C. Memo. 2012-99	Unreported fees for services	Yes	IRS
Lay, Estate of v. Comm'r, T.C. Memo. 2011-208, *appeal dismissed*, No. 11-60825 (5th Cir. Jan. 27, 2012)	Reported sale of annuity contracts not includable as deferred compensation or part payment/part compensation to an employee	No	TP
Leak v. Comm'r, T.C. Summ. Op. 2012-39	Unreported Schedule C income determined under bank deposit analysis	Yes	Split
Licha v. Comm'r, T.C. Memo. 2011-275, *appeal docketed*, No. 12-72170 (9th Cir. July 9, 2012)	Unreported business income	Yes	IRS
Lua v. Comm'r, T.C. Memo. 2011-192	Unreported Schedule C income	No	TP
Martignon v. Comm'r, T.C. Summ. Op. 2012-18	Distributive share of partnership income is includable even if partner received no distribution	Yes	IRS
Mwangachuchu v. Comm'r, T.C. Memo. 2012-86	Unreported business income	No	IRS
Olmstead v. Comm'r, T.C. Summ. Op. 2011-118	Unreported *pro rata* share of income from an S corporation; unreported employee compensation	Yes	IRS
Onyekwena v. Comm'r, T.C. Summ. Op. 2012-37	Unreported Schedule C gross receipts determined under bank deposit analysis	Yes	IRS
Owen v. Comm'r, T.C. Memo. 2012-21	Unreported fees; unreported bonus, commission, and termination payment decided under the assignment of income doctrine; unreported gain from sale of qualified small business stock	No	Split
Payan v. Comm'r, T.C. Summ. Op. 2011-80	Unreported Schedule E rental income	Yes	IRS
Plotkin v. Comm'r, T.C. Memo. 2011-260, *appeal docketed*, No. 12-10620 (11th Cir. Feb. 6, 2012)	Unreported Schedule C income	No	IRS
Porch v. Comm'r, T.C. Summ. Op. 2012-25	Unreported Schedule C income	No	IRS
Rogers v. Comm'r, T.C. Memo. 2011-277, *appeal docketed*, No. 12-2652 (7th Cir. July 13, 2012)	Unreported business income	No	IRS
Rovakat, LLC v. Comm'r, T.C. Memo. 2011-225, *appeal docketed*, No. 12-1779 (3rd Cir. Mar. 26, 2012)	Unreported fees for services	No	Split
Scott v. Comm'r, T.C. Memo. 2012-65	Unreported business income determined under bank deposit analysis	No	IRS
West v. Comm'r, T.C. Memo. 2012-148	Unreported business income determined under bank deposit analysis	Yes	IRS
White v. Comm'r, T.C. Memo. 2012-104	Unreported constructive dividend from insurance plan distribution; unreported proceeds from plan termination	No	Split
Wickersham v. Comm'r, T.C. Memo. 2011-178	Unreported gain on sale of business assets and easement; unreported gain on sale of residence excluded under § 121	No	Split
Willson v. Comm'r, T.C. Summ. Op. 2011-132	Unreported gain from condemnation of business property	Yes	IRS

Table 6 Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Adler v. Comm'r, 443 Fed. Appx. 736 (3d Cir. 2011), *aff'g* T.C. Memo. 2010-47, *cert. denied*, 132 S. Ct. 1911 (2012)	6651(a)(1); 6654; no evidence of reasonable cause or exception presented	Yes	IRS
Anderson v. Comm'r, T.C. Summ. Op. 2011-84	6651(a)(1); TP anticipated federal refund and did not file; no evidence of reasonable cause presented	Yes	IRS
Block, Estate of v. Comm'r, T.C. Memo. 2011-145	6651(a)(1), (a)(2); 6654; no evidence of reasonable cause or exception presented	No	IRS
Cahill v. Comm'r, T.C. Memo. 2011-203	6651(a)(1), (a)(2); 6654; TP failed to substantiate reliance on attorney and stockbroker; TP became disabled several years before the tax year at issue; no evidence of reasonable cause or exception presented	No	IRS
Caton v. Comm'r, T.C. Memo. 2012-92	6651(a)(2); 6654; no evidence of reasonable cause or exception presented	Yes	IRS
Cayabyab v. Comm'r, T.C. Memo. 2012-89	6651(a)(1); unavailability of documents and divorce; no evidence of reasonable cause presented	Yes	IRS
Coaxum, Estate of v. Comm'r, T.C. Memo. 2011-135, *appeal docketed*, No. 12-2052 (4th Cir. Aug. 28, 2012)	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Farhoumand v. Comm'r, T.C. Memo. 2012-131	6654; stock market losses were not an unusual circumstance; no exception presented	No	IRS
Felt v. Comm'r, 433 Fed. Appx. 293 (5th Cir. 2011), *aff'g* T.C. Memo. 2009-245	6651(a)(1); 6654; TP (W) sought relief claiming she lacked information necessary to file returns, however the court held TP (H) did not conceal sources of business income; no evidence of reasonable cause or exception presented	No	IRS
Fonteneaux v. Comm'r, T.C. Memo. 2012-44, *appeal docketed*, No. 12-60418 (5th Cir. May 29, 2012)	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Freeman v. U.S., 109 A.F.T.R.2d (RIA) 723 (E.D. Pa. 2012)	6651(a)(1); executor's late filing of Form 706 was due to estate attorney's illness; no evidence of reasonable cause presented	No	IRS
Garber v. Comm'r, T.C. Memo. 2012-47, *appeal docketed*, No. 12-2278 (7th Cir. May 29, 2012)	6651(a)(1), (a)(2); no evidence of reasonable cause presented	Yes	IRS
Greenwald v. Comm'r, T.C. Memo. 2011-239	6651(a)(1); TP relied on accounting firm to file and obtain extension; no evidence of reasonable cause presented	No	IRS
Gutierrez v. Comm'r, T.C. Memo. 2011-263	6651(a)(1); TP was preoccupied with wife's immigration problems; no evidence of reasonable cause presented	Yes	IRS
Holloway v. Comm'r, T.C. Memo. 2012-137	6651(a)(1), (a)(2); 6654; nonfiler; no evidence of reasonable cause or exception presented	Yes	IRS
Ioane v. Comm'r, 442 Fed. Appx. 269 (9th Cir. 2011), *aff'g* T.C. Memo. 2009-68	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Jackson v. Comm'r, T.C. Memo. 2012-58	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Johnson v. Comm'r, T.C. Summ. Op. 2012-13	6651(a)(1); no evidence of reasonable cause presented	No	IRS
In re: Krause, 108 A.F.T.R.2d (RIA) 6098 (Bankr. E.D. Tenn. 2011)	6651(a)(1); nonfiler; failure to file penalties found inapplicable for years with no income because TP was not required to file returns	No	TP
Lain v. Comm'r, T.C. Memo. 2012-99	6651(a)(2); 6654; no evidence of reasonable cause or exception presented	Yes	IRS
Laue v. Comm'r, T.C. Memo. 2012-105	6651(a)(1); 6654; nonfiler; no evidence of reasonable cause or exception presented	Yes	IRS

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Table 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
McHaney v. Comm'r, T.C. Memo. 2012-120	6651(a)(1), (a)(2); nonfiler; no evidence of reasonable cause presented	Yes	IRS
McLaine v. Comm'r, 138 T.C. No. 10 (2012)	6651(a)(2); 6654; no evidence of reasonable cause or exception presented	No	IRS
McNeil v. Comm'r, T.C. Memo. 2011-150, *aff'd*, 451 Fed. Appx. 622 (8th Cir. 2012)	6651(a)(1), (a)(2); 6654; TP reported all "zeros" on return; no evidence of reasonable cause or exception presented	Yes	IRS
Moragne, Estate of v. Comm'r, T.C. Memo. 2011-299	6651(a)(1), (a)(2); 6654; unsubstantiated claim that TP was incompetent; no evidence of reasonable cause or exception presented	No	IRS
Nagel v. Comm'r, T.C. Memo. 2011-184	6651(a)(1); unsubstantiated claim of valid extension for filing granted by TAS caseworker; no evidence of reasonable cause presented	Yes	IRS
Nasir v. Comm'r, T.C. Memo. 2011-283	6651(a)(1), (a)(2); 6654; TP suffered financial hardship and wife experienced prolonged illness; no evidence of reasonable cause or exception presented	Yes	IRS
O'Bryant v. Comm'r, T.C. Summ. Op. 2011-101	6651(a)(1); TP satisfied the reasonable cause exception; TP provided constant care for severely injured and incapacitated wife after accident	Yes	TP
Palmer v. Comm'r, T.C. Memo. 2012-34, *appeal docketed*, No. 12-9002 (10th Cir. May 18, 2012)	6651(a)(1), (a)(2); nonfiler; no evidence of reasonable cause presented	Yes	IRS
Palmer v. Comm'r, 109 A.F.T.R.2d (RIA) 2343 (10th Cir. 2012), *aff'g* Tax Ct. Docket No. 17755-10	6651(a)(1), (a)(2); 6654; nonfiler; no evidence of reasonable cause or exception presented	Yes	IRS
Parker v. Comm'r, T.C. Memo. 2012-66	6651(a)(1); TP reported all "zeros" on return; no evidence of reasonable cause presented	Yes	IRS
Paschall v. Comm'r, 137 T.C. 8 (2011)	6651(a)(1): nonfiler; TP relied on advice of a tax advisor with a conflict of interest in promoting a transaction; no evidence of reasonable cause presented	No	IRS
Perkins v. Comm'r, T.C. Memo. 2011-207	6654; no exception presented	Yes	IRS
Pierro v. Comm'r, 109 A.F.T.R.2d (RIA) 1299 (9th Cir. 2012), *aff'g* Tax Ct. Docket No. 18809-07	6651(a)(1), (a)(2); nonfiler; payment to IRS on TP's behalf was income, so TP was required to file; no evidence of reasonable cause presented	Yes	IRS
Reyes v. Comm'r, T.C. Memo. 2012-129	6651(a)(1), (a)(2); 6654; nonfiler; no evidence of reasonable cause or exception presented	Yes	IRS
Richmond v. Comm'r, T.C. Memo. 2011-251, *aff'd*, 474 Fed.Appx. 754 (10th Cir. 2012)	6651(a)(1), (a)(2); TP reported all "zeros" on return; no evidence of reasonable cause presented	Yes	IRS
Rossman v. U.S., 109 A.F.T.R.2d (RIA) 985 (Fed. Cl. 2012)	6651(a)(2); no evidence of reasonable cause presented	No	IRS
Todd v. Comm'r, T.C. Memo. 2011-123, *aff'd*, 2012 WL 3530259 (5th Cir. 2012)	6651(a)(1); no evidence of reasonable cause presented	No	IRS
Weinberger v. Comm'r, T.C. Summ. Op. 2012-41	6651(a)(1); TPs (H&W) work long hours and care for a large family; no evidence of reasonable cause presented	No	IRS
Wheeler v. Comm'r, 446 Fed. Appx. 951 (10th Cir. 2011), *aff'g* T.C. Memo. 2010-188	6651(a)(1), (a)(2); 6654; nonfiler; no evidence of reasonable cause or exception presented	Yes	IRS
In re Williams, 109 A.F.T.R.2d (RIA) 2365 (Bankr. D. Neb. 2012)	6651(a)(1); 6654; TP suffered from knee injuries; no evidence of reasonable cause or exception presented	No	IRS
Zarra, U.S. v., 810 F. Supp. 2d 758 (W.D. Pa. 2011), *aff'd*, 109 A.F.T.R.2d (RIA) 1837 (3d Cir. 2012)	6651(a)(2); no evidence of reasonable cause presented	No	IRS
Zurn v. Comm'r, T.C. Memo. 2012-132	6651(a)(1); no evidence of reasonable cause presented	No	IRS
Business Taxpayers (Corporations, Partnerships, Trust and Sole Proprietorships – Schedules C, E, F)			
Alridge v. Comm'r, T.C. Summ. Op. 2011-96	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Bailey v. Comm'r, T.C. Memo. 2012-96	6651(a)(1); TP(H)'s care of TP(W) for chronic illness was reasonable cause for tax year 1998; no evidence of reasonable cause presented for tax year 1999 and 2000	Yes	Split
Bell v. Comm'r, T.C. Memo. 2011-296	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS

Table 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Concert Staging Servs. v. Comm'r, T.C. Memo. 2011-231	6651(a)(2); TP made unsubstantiated claim that due to a downturn in business, he was unable to pay the tax without suffering undue hardship despite having exercised ordinary business care and prudence; no evidence of reasonable cause presented	No	IRS
Custom Stairs & Trim, Ltd. v. Comm'r, T.C. Memo. 2011-155	6651(a)(2); TP proved reasonable cause by showing that it exercised ordinary business care and prudence by downsizing, selectively paying expenses, and attempting to sell real property to pay tax, interest and penalties	Yes	TP
D & R Fin. Servs. v. Comm'r, T.C. Memo. 2011-252	6651(a)(1), (a)(2); no evidence of reasonable cause presented	Yes	IRS
DeVries v. Comm'r, T.C. Memo. 2011-185	6651(a)(1), (a)(2); 6654; no evidence of reasonable cause or exception presented	Yes	IRS
Esrig v. Comm'r, T.C. Memo. 2012-38	6651(a)(1); 6654; no evidence of reasonable cause or exception presented	Yes	IRS
Fein v. Comm'r, T.C. Memo. 2011-142, *appeal docketed*, No. 11-3760 (2d Cir. Sept. 20, 2011)	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Fernandez v. Comm'r, T.C. Memo. 2011-216	6651(a)(1), (a)(2); 6654; no evidence of reasonable cause or exception presented	Yes	IRS
Gleason v. Comm'r, T.C. Memo. 2011-154	6651(a)(1), (a)(2); 6654; no evidence of reasonable cause presented; IRS failed to meet burden of production for 6654 in TY 2001 for TP(H)	Yes	Split (IRS 6651(a)(1), (a)(2) TP(H), 6654 TP (H) for 2002 and 2003; TP (W) 6651(a)(2), TP(H) 6654 for 2001, TP(W) 6654 for 2001 and 2003)
Gunn v. Comm'r, T.C. Summ. Op. 2011-133	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Keller v. Comm'r, T.C. Memo. 2012-62	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Kilker v. Comm'r, T.C. Memo. 2011-250	6651(a)(1), (a)(2); 6654; nonfiler; no evidence of reasonable cause or exception presented; IRS failed to meet burden of production for 6651(a)(2)	Yes	Split (IRS 6651(a)(1), 6654; IRS 6651(a)(2))
Mali v. Comm'r, T.C. Memo. 2011-121	6651(a)(1); TP experienced acute financial difficulties and was unaware of penalty; no evidence of reasonable cause presented	Yes	IRS
Moore v. Comm'r, T.C. Summ. Op. 2012-16	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Moredock v. Comm'r, 456 Fed. Appx. 764 (10th Cir. 2012), *aff'g* Tax Ct. Docket No. 10704-09	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Moreira v. Comm'r, T.C. Summ. Op. 2011-93	6651(a)(1), (a)(2); 6654; TP's reliance on managing partner to file partnership tax returns and pay tax was reasonable cause for not doing so; no exception presented for failure to pay estimated taxes	No	Split (TP 6651(a)(1), (a)(2); IRS 6654)
Nordeen v. Comm'r, T.C. Summ. Op. 2011-104	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Penland v. Comm'r, T.C. Memo. 2011-274	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Plotkin v. Comm'r, T.C. Memo. 2011-260, *appeal docketed*, No. 12-10620 (11th Cir. Feb. 6, 2012)	6654; no exception presented	No	IRS
Rinehart v. Comm'r, T.C. Memo. 2012-112	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Roumi v. Comm'r, T.C. Memo. 2012-2	6651(a)(1); no evidence of reasonable cause presented	Yes	IRS
Schoppe v. Comm'r, T.C. Memo. 2012-153, *appeal docketed*, No. 12-9010 (10th Cir. Sept. 12, 2012)	6651(a)(1), (a)(2); 6654; no evidence of reasonable cause or exception presented	Yes	IRS
Schuman Aviation Co. v. U.S., 816 F. Supp. 2d 941 (D. Haw. 2011)	6651(a)(2); no evidence of reasonable cause presented	No	IRS
Thompson v. Comm'r, T.C. Memo. 2011-291	6651(a)(1), (a)(2); 6654; nonfiler; no evidence of reasonable cause or exception presented	Yes	IRS

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Table 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
West v. Comm'r, T.C. Memo. 2011-272	6651(a)(1), (a)(2); 6654; TP argued ignorance of the law; no evidence of reasonable cause presented; IRS failed burden of production for 6654 for TY 2000	Yes	Split (IRS 6651(a)(1), (a)(2), 6654 for TYs 2001-2005; TP 6654 for TY 2000)
West v. Comm'r, T.C. Memo. 2012-148	6651(a)(1); TP believed that she was not required to file; no evidence of reasonable cause presented	Yes	IRS
Westerman v. Comm'r, T.C. Memo. 2011-204	6651(a)(1); unsubstantiated reliance on accountant; no evidence of reasonable cause presented	Yes	IRS
Whitney v. Comm'r, T.C. Summ. Op. 2011-106	6651(a)(1), (a)(2); TP claimed inability to determine tax because of missing Schedule K-1; no evidence of reasonable cause presented	Yes	IRS
Zweifel v. Comm'r, T.C. Memo. 2012-93	6651(a)(1); no evidence of reasonable cause presented	No	IRS

Table 7 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Arthur, U.S. v., 109 A.F.T.R.2d (RIA) 1939 (E.D. Mo. 2012)	Federal tax liens valid and foreclosed against TP's real property	No	IRS
Barczyk, U.S. v., 434 Fed. Appx. 488 (6th Cir. 2011) (per curiam), *aff'g* 697 F. Supp. 2d 789 (E.D. Mich. 2010), *cert. denied*, 132 S. Ct. 1118 (2012)	Affirmed lower court's decision to foreclose against TP's jointly owned real property even though non-liable spouse has an interest in property	No	IRS
Brick, U.S. v., 108 A.F.T.R.2d (RIA) 7227 (S.D. W. Va. 2011)	Federal tax liens valid and foreclosed against TP's property even though non-liable ex-spouse has an interest in the property	Yes	IRS
Buaiz, U.S. v., 108 A.F.T.R.2d (RIA) 5856 (E.D. Tenn. 2011)	Federal tax lien valid and foreclosed against TP's property even though other family members have an interest in the property	Yes	IRS
Caraway, U.S. v., 108 A.F.T.R.2d (RIA) 7243 (N.D. Cal. 2011)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
Chesir, U.S. v., 108 A.F.T.R.2d (RIA) 5450 (E.D.N.Y. 2011), *motion to vacate denied by* 2012 U.S. Dist. LEXIS 76519 (E.D.N.Y. 2012), *appeal docketed*, No. 12-2531 (2d Cir. June 22, 2012)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
Crissman, U.S. v., 108 A.F.T.R.2d (RIA) 6462 (M.D. Pa. 2011), *reconsideration denied by* 108 A.F.T.R.2d (RIA) 7059 (M.D. Pa. 2011)	Federal tax lien valid and foreclosed against TP's proceeds from real property; government's motion for summary judgment asserting priority over other claimants denied	No	IRS
Fitch, U.S. v., 108 A.F.T.R.2d (RIA) 5428 (D. Idaho 2011)	Federal tax liens valid and foreclosed against TP's real property, despite transfer by divorce decree	No	IRS
Ford, U.S. v., 109 A.F.T.R.2d (RIA) 1201 (E.D. Mich. 2012)	Federal tax liens valid and foreclosed against new owner of real property with knowledge of lien	No	IRS
Hiatt, U.S. v., 109 A.F.T.R.2d (RIA) 1720 (W.D. Wash. 2012), *vacating in part* 108 A.F.T.R.2d (RIA) 7473 (W.D. Wash. 2011), *appeal docketed*, No. 12-35369 (9th Cir. May 9, 2012)	Federal tax liens valid and foreclosed against TP's real property; court vacated prior order granting summary judgment only in part for IRS	Yes	IRS
Howard, U.S. v., 442 Fed. Appx. 262 (9th Cir. 2011), *aff'g* 102 A.F.T.R.2d (RIA) 5601 (D. Ariz. 2008)	Affirmed lower court's decision to foreclose against TP's real property	Yes	IRS
Krute, U.S. v., 109 A.F.T.R.2d (RIA) 1228 (E.D. Cal. 2012)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
McCullough, U.S. v., 108 A.F.T.R.2d (RIA) 6732 (W.D. Pa. 2011)	Federal tax liens valid and foreclosed against real property purchased with the proceeds from the sale of the original real property encumbered by the tax lien	No	IRS
O'Callaghan, U.S. v., 107 A.F.T.R.2d (RIA) 2745 (M.D. Fla. 2011), *motion to stay denied by* 805 F. Supp. 2d 1321 (M.D. Fla. 2011), *appeal docketed*, No. 11-12975 (11th Cir. July 1, 2011)	After court granted summary judgment in favor of IRS, TP objected to the motion and order for sale; court reaffirmed that federal tax liens were valid and foreclosed	No	IRS
O'Callaghan, U.S. v., 108 A.F.T.R.2d (RIA) 5158 (M.D. Fla. 2011), *appeal docketed*, No. 11-12811 (11th Cir. June 21, 2011)	Federal tax liens valid and foreclosed against TP's real property	No	IRS
Odani, U.S. v., 108 A.F.T.R.2d (RIA) 6806 (D. Haw. 2011)	Federal tax liens valid and foreclosed against TP's real property jointly owned with sister	Yes	IRS
Panter, 109 A.F.T.R.2d (RiA) 2535 (D. Or. 2012) *adopting* 109 A.F.T.R.2d (RIA) 2525 (D. Or. 2012)	Federal tax lien valid and foreclosed against TP's real property	Yes	IRS
Parr, U.S. v., 108 A.F.T.R.2d (RIA) 6516 (W.D. Va. 2011)	Federal tax liens valid and foreclosed against TP's real property, despite non-liable W's interest in the property as tenant by the entirety	Yes	IRS
Powell, U.S. v., 108 A.F.T.R.2d (RIA) 7543 (S.D. Ohio 2011)	Granted summary judgment to allow foreclosure sale against one parcel of real property but denied summary judgment on another	No	IRS

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Table 7: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Rivetts, U.S. v.,109 A.F.T.R.2d (RIA) 2127 (D. Minn. 2012)	Federal tax liens valid and foreclosed against TPs' (H&W) residence even though sale might cause hardship to family members living in property	No	IRS
Shore, U.S. v., 109 A.F.T.R.2d (RIA) 1689 (E.D. Ca. 2012)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
Smith, U.S. v., 109 A.F.T.R.2d (RIA) 772 (W.D. Ky. 2012)	Federal tax liens valid and foreclosed against TP's real property even though non-liable spouse has interest in property	No	IRS
Steinmaus, U.S. v., 108 A.F.T.R.2d (RIA) 6059 (D. Minn. 2011)	Federal tax liens valid and foreclosed against TP's real property	No	IRS
Tellez, U.S. v., 107 A.F.T.R.2d (RIA) 2423 (W.D. Tex. 2011), *appeal dismissed*, No. 11-50606 (5th Cir. Mar. 26, 2012)	Federal tax liens valid and foreclosed against TP's real property; spouse has no community property interest	No	IRS
Winsper, U.S. v., 680 F.3d 482 (6th Cir. 2012), *rev'g* 106 A.F.T.R.2d (RIA) 5130 (W.D. Ky. 2010)	Lower court's decision not to foreclose against TP's real property was reversed and remanded for abuse of discretion	No	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedules C, E, F)			
Ansel Capital Inv., LLC v. U.S., 448 Fed. Appx. 709 (9th Cir. 2011), *aff'g* 2010 U.S. Dist. LEXIS 41977 (D. Mont. 2010)	Affirmed lower court's order authorizing the sale of real property even though party with an interest in property objected	No	IRS
Beeman, U.S. v., 108 A.F.T.R.2d (RIA) 5402 (W.D. Pa. 2011), *judgment entered by* 2011 U.S. Dist. LEXIS 79978 (W.D. Pa. 2011), *aff'd*, No. 11-3304 (3d Cir. Mar. 20, 2012)	Federal tax liens valid and foreclosed against TP's real property held by corporate nominees	Yes	IRS
Bibin, U.S. v., 108 A.F.T.R.2d (RIA) 7579 (E.D. Mich. 2011)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
Black, U.S. v., 109 A.F.T.R.2d (RIA) 2282 (9th Cir. 2012), *aff'g* 106 A.F.T.R.2d (RIA) 5320 (E.D. Wash. 2010) and 725 F. Supp. 2d 1279 (E. D. Wash. 2010)	Affirmed lower court's decision to foreclose against TPs' (H&W) real property, and property held by alter ego corporation	Yes	IRS
Brice, U.S. v., 109 A.F.T.R.2d (RIA) 1613 (W.D. Mo. 2012)	Federal tax liens valid and foreclosed against TP's real and personal property held by trust nominee	No	IRS
Brown, U.S. v., 108 A.F.T.R.2d (RIA) 6755 (D. Utah 2011), *appeal docketed*, No. 12-4000 (10th Cir. Jan. 3, 2012)	Federal tax liens valid and foreclosed against TPs' (H&W) real property; trust was a nominee	No	IRS
Burnett, U.S. v., 452 Fed. Appx. 569 (5th Cir. 2011), *aff'g* 106 A.F.T.R.2d (RIA) 6699 (S.D. Tex. 2010)	Affirmed lower court's decision to foreclose against TP's real property; trust was a nominee	No	IRS
Chikara Enters., LLC v. U.S., 108 A.F.T.R.2d (RIA) 5686 (D. Utah 2011)	Federal tax liens valid and foreclosed against TP's real property held by trust nominee; TP's transfer of property to religious trust was fraudulent	No	IRS
Corry Communications, U.S. v., 108 A.F.T.R.2d (RIA) 6521 (W.D. Pa. 2011)	Foreclosure of federal tax liens on broadcast license not appropriate	No	TP
Crockett, U.S. v., 109 A.F.T.R.2d (RIA) 625 (W.D. Mo. 2012)	Foreclosure of federal tax liens on proceeds from the sale of property subject to a tax lien appropriate	No	IRS
Davis, U.S. v., 108 A.F.T.R.2d (RIA) 7236 (N.D. Fla. 2011)	Federal tax liens valid and foreclosed against TP's real property held as co-successor trustee	Yes	IRS
Eckhardt v. U.S., 109 A.F.T.R.2d (RIA) 1414 (11th Cir. 2012) (per curiam), *aff'g* 2010 U.S. Dist. LEXIS 142176 (S.D. Fla. 2010)	Affirmed lower court's decision to foreclose against TP's property held by TP's alter ego corporation	No	IRS
Ippolito, U.S. v., 109 A.F.T.R.2d (RIA) 1083 (M.D. Fla. 2012)	Federal tax liens valid and foreclosed against decedent TP's real property; property held by TP's corporate nominee	Yes	IRS
Jones, U.S. v., 109 A.F.T.R.2d (RIA) 1072 (C.D. Cal. 2012)	Federal tax liens valid and foreclosed against TPs' (H&W) real property held by trusts and other entities as TPs' nominees	Yes	IRS
Ledford, U.S. v., 109 A.F.T.R.2d (RIA) 1643 (D. Colo. 2012)	Trust was nominee subject to federal tax liens and foreclosure	Yes	IRS
Maris, U.S. v., 109 A.F.T.R.2d (RIA) 775 (D. Nev. 2012), *motion to vacate denied by* 109 A.F.T.R.2d (RIA) 2094 (D. Nev. 2012), *appeal docketed*, No. 12-15422 (9th Cir. Feb. 29, 2012)	Federal tax liens valid against TPs' (H&W) real property, but summary judgment granting foreclosure denied because government failed to show that there is no reasonable alternative for collecting debt	Yes	IRS

Table 7: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Melot, U.S. v., 109 A.F.T.R.2d (RIA) 427 (D.N.M. 2012), *judgment entered by* 109 A.F.T.R.2d (RIA) 1568 (D.N.M. 2012), *appeal docketed*, No. 12-2055 (10th Cir. Apr. 6, 2012)	Federal tax liens valid and foreclosed against TPs' (H&W) real and personal property held by corporate nominee	Yes	IRS
Sanchez-Martinez, U.S. v., 109 A.F.T.R.2d (RIA) 2183 (E.D.N.C. 2012)	Federal tax liens valid and foreclosed against TP's real property held by corporate and family nominees	Yes	IRS
Smith, U.S. v., 108 A.F.T.R.2d (RIA) 5385 (E.D. Cal. 2011)	Federal tax liens valid and foreclosed against TP's real property; trust is the alter ego of TP	Yes	IRS
Springer, U.S. v., 427 Fed. Appx. 650 (10th Cir. 2011), *aff'g* 105 A.F.T.R.2d (RIA) 1192 (N.D. Okla. 2010), *cert. denied*, 132 S.Ct. 2729 (2012)	Affirmed lower court's decision to foreclose against TP's real property; trust was a nominee	No	IRS
Stewart, U.S. v., 109 A.F.T.R.2d (RIA) 455 (W.D. Pa. 2012)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Washington, U.S. v., 108 A.F.T.R.2d (RIA) 6121 (S.D. Tex. 2011)	Court found that federal tax lien for liabilities incurred in 1990 did not attach to property, but that all other liens did and ordered foreclosure with respect to those liens	No	Split
Yu, U.S. v., 109 A.F.T.R.2d (RIA) 975 (E.D. Pa. 2012), *reconsideration granted in part and denied in part by* 109 A.F.T.R.2d (RIA) 1444 (E.D. Pa. 2012)	Federal tax liens valid and foreclosed against TP's real property	No	IRS

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TABLE 8 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
Individual Taxpayers (But not Sole Proprietorships)				
Alderman v. Comm'r, T.C. Memo. 2012-130	Taxpayer petitioned for redetermination of deficiency and penalties and asserted frivolous arguments	Yes	IRS	$4,000
Barry v. Comm'r, T.C. Memo. 2011-127	Taxpayers (H&W) requested face-to-face hearings and argued that only federal employees or those who live in "federal zones" or "IRS districts" are liable for income taxes	Yes	IRS	$40,000 (3 consolidated cases)
Byrd v. Comm'r, T.C. Memo. 2011-146, *appeal dismissed*, No. 11-2104 (6th Cir. Oct. 4, 2011)	Taxpayers (H&W) petitioned for redetermination of IRS decision to proceed with collection and maintained proceedings solely to delay collection	Yes	IRS	$2,000
Callihan v. Comm'r, T.C. Memo. 2011-268, *aff'd*, No. 12-11586 (11th Cir Sept. 25, 2012)	Taxpayer petitioned for redetermination of deficiency and argued that Florida and the other states are not part of the definition of the United States and his income is not taxable at a federal level	Yes	TP	
Campbell v. Comm'r, T.C. Memo. 2012-82	Taxpayer petitioned for review of IRS decision to proceed with collection and argued he never received IRS notices	Yes	TP	
Caton v. Comm'r, T.C. Memo. 2012-92	Taxpayer petitioned for redetermination of deficiency and argued the income tax is unconstitutional or voluntary and he is not a person subject to income tax	Yes	IRS	$5,000
Devlin v. Comm'r, T.C. Memo. 2012-145	Taxpayer petitioned for review of IRS decision to proceed with collection and argued no statute requires him to pay income tax	Yes	TP	
Garber v. Comm'r, T.C. Memo. 2012-47, *appeal docketed*, No. 12-2278 (7th Cir. May 29, 2012)	Taxpayer petitioned for redetermination of deficiency and argued no statute requires him to pay income tax and only withholding agents must pay income tax	Yes	IRS	$1,000
Hatch v. Comm'r, T.C. Memo. 2012-50, *appeal docketed*, No. 12-14133 (11th Cir. Aug. 9, 2012)	Taxpayer petitioned for redetermination of deficiency and penalty and argued she earned no income but was given a gift by the company she worked for	Yes	TP	
Jackson v. Comm'r, T.C. Memo. 2012-58	Taxpayer petitioned for review of IRS decision to proceed with collection and argued he was not a taxpayer and delayed proceedings	Yes	IRS	$15,000
Laue v. Comm'r, T.C. Memo. 2012-105	Taxpayer petitioned for redetermination of deficiency and argued that his income for labor is not taxable and that because IRS initially processed returns as valid, IRS was bound to accept them	Yes	IRS	$5,000
Parker v. Comm'r, T.C. Memo. 2012-66	Taxpayer petitioned for redetermination of deficiency and argued that there is no basis for imposing Federal income tax on the wages of private sector employees	Yes	IRS	$3,000
Wheeler v. Comm'r, T.C. Memo. 2011-278	Taxpayer petitioned for redetermination of deficiency and additions to tax and asserted frivolous arguments	Yes	IRS	$25,000
Section 6673 Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments				
Alexander v. Comm'r, T.C. Memo. 2012-75	Taxpayer petitioned for redetermination of deficiency and asserted her employer was not a wage payer for FICA purposes	Yes		
Anderson v. Comm'r, T.C. Memo. 2012-46	Taxpayer petitioned for review of IRS decision to proceed with collection; may have instituted proceedings to delay collection	Yes		
Carlson v. Comm'r, T.C. Memo. 2012-76, *appeal docketed*, No. 12-72030 (9th Cir. June 26, 2012)	Taxpayer petitioned for review of IRS decision to proceed with collection and argued that Washington and Oregon are not part of the United States and therefore she is not subject to federal income tax	Yes		
D'Arcy v. Comm'r, T.C. Memo. 2011-213	Taxpayer petitioned for review of IRS decision to proceed with collection and argued he is a nontaxpayer because he is a resident of the Republic of Florida	Yes		
Licha v. Comm'r, T.C. Memo. 2011-275, *appeal docketed*, No. 12-72170 (9th Cir. July 9, 2012)	Taxpayers (H&W) petitioned for redetermination of deficiency and penalties and argued that deficiencies are not properly determined; citizens of the Republic State of CA are not citizens of the U.S.; tax forms are invalid because they lack OMB control numbers	Yes		
Perkins v. Comm'r, T.C. Memo. 2011-207	Taxpayer petitioned for redetermination of deficiency and additions to tax and argued that the Form W-2 his employer issued is invalid	Yes		

Table 8: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
Reyes v. Comm'r, T.C. Memo. 2012-129	Taxpayer petitioned for redetermination of deficiency and additions to tax and argued the IRS has no authority to prepare a substitute for return; raised frivolous arguments primarily for delay	Yes		
Reyes v. Comm'r, 449 Fed. Appx. 478 (6th Cir. 2011), aff'g T.C. Docket No. 4324-09 L (Feb. 17, 2010)	Taxpayer appealed Tax Court's decision upholding IRS decision to proceed with collection and argued that he is not a taxpayer and has no liability to file Federal income tax returns; may have instituted proceedings solely for delay	Yes		
Slingsby v. Comm'r, T.C. Memo. 2011-130	Taxpayer petitioned for redetermination of deficiency and argued that only public employees pay taxes and that the Form W-2 his employer issued is invalid	Yes		
Superior Trading, LLC v. Comm'r, T.C. Memo. 2012-110, *appeal docketed*, No. 12-3367 (7th Cir. Oct. 16, 2012)	Business taxpayer petitioned for review of IRS's final partnership administrative adjustments decision; may have instituted proceedings solely for delay	No		
Thompson v. Comm'r, T.C. Memo. 2011-291	Taxpayer petitioned for redetermination of deficiency and argued that he disagreed with the wars in Iraq and Afghanistan and that paying taxes would violate the Nuremberg Principles	Yes		
US Courts of Appeals' Decisions on Appeal of Section 6673 Penalties Imposed by US Tax Court				
Bates v. Comm'r, 436 Fed. Appx. 767 (9th Cir. 2011), *aff'g* T.C. Docket No. 1586-08 (July 21, 2009)	Penalty affirmed	Yes	IRS	$2,500
Bates v. Comm'r, 436 Fed. Appx. 790 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-152	Penalty affirmed	Yes	IRS	$1,000
Diemer v. Comm'r, 448 Fed. Appx. 385 (4th Cir. 2011), *aff'g* T.C. Docket No. 13123-10 (Feb. 16, 2011)	Penalty affirmed	Yes	IRS	$2,500
Dykema v. Comm'r, 447 Fed. Appx. 757 (8th Cir. 2012), *aff'g* T.C. Docket No. 430-11 (June 1, 2011)	Penalty affirmed	Yes	IRS	$1,000
Houseal v. Comm'r, 435 Fed. Appx. 567 (8th Cir. 2011), *aff'g* T.C. Docket No. 24441-10 (Jan. 26, 2011)	Penalty affirmed	Yes	IRS	$1,000
Ioane v. Comm'r, 442 Fed. Appx. 269 (9th Cir. 2011), *aff'g* T.C. Memo. 2009-68	Penalty affirmed	Yes	IRS	$10,000
Jahn v. Comm'r, 431 Fed. Appx. 210 (3rd Cir. 2011), *aff'g* T.C. Docket No. 24302-08 (Dec. 23, 2009)	Penalty affirmed	Yes	IRS	$10,000
Lee v. Comm'r, 463 Fed. Appx. 236 (5th Cir. 2012), *aff'g* T.C. Docket No. 16260-10L (Mar. 25, 2011)	Penalty affirmed	Yes	IRS	$1,000
Mills v. Comm'r, 444 Fed. Appx. 951 (9th Cir. 2011),, aff'g T.C. Docket No. 3441-08 (Apr. 15, 2009)	Penalty affirmed	Yes	IRS	$20,000
O'Boyle v. Comm'r, 464 Fed. Appx. 4 (D.C. Cir. 2012), *aff'g* T.C. Memo. 2010-149 (This case consolidated T.C. Docket No. 30214-07 and T.C. Docket No. 30215-07)	Penalty affirmed and allocated evenly between the two consolidated Tax Court dockets	Yes	IRS	$30,000
Swanson v. Comm'r, 438 Fed. Appx. 582 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-265	Penalty affirmed	No	IRS	$12,500
Tinnerman v. Comm'r, 448 Fed. Appx. 73 (D.C. Cir. 2012), *aff'g* T.C. Memo. 2010-150	Penalty affirmed	No	IRS	$25,000
Weybrew v. Comm'r, 451 Fed. Appx. 257 (4th Cir. 2011), *aff'g* T.C. Docket No. 14868-10 L (Feb. 16, 2011)	Penalty affirmed	Yes	IRS	$2,500
Wheeler v. Comm'r, 446 Fed. Appx. 951 (10th Cir. 2011), *aff'g* T.C. Memo. 2010-188	Penalty affirmed	Yes	IRS	$25,000

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Table 8: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
U.S. Courts of Appeals' Decisions on Sanctions Under Section 7482 (c)(4), FRAP Rule 38, or Other Authority				
Dykema v. Comm'r, 447 Fed. Appx. 757 (8th Cir. 2012), *aff'g* T.C. Docket No. 430-11 (June 1, 2011)	Taxpayer appealed Tax Court's decision to dismiss his petition challenging the notice of deficiency and to impose sanctions and asserted frivolous arguments	Yes	IRS	$5,000
Houseal v. Comm'r, 435 Fed. Appx. 567 (8th Cir. 2011), *aff'g* T.C. Docket No. 24441-10 (Jan. 26, 2011)	Taxpayer appealed Tax Court's decision to dismiss his petition challenging the notices of deficiency and argued his income is not taxable	Yes	IRS	$8,000
Palmer v. Comm'r, 109 A.F.T.R.2d (RIA) 2343 (10th Cir. 2012), *aff'g* T.C. Docket No. 17755-10 (Oct. 19, 2011)	Taxpayer appealed Tax Court's decision on redetermination of deficiency and application of penalties and argued that IRS agents lacked authority to implement the IRC	Yes	IRS	$4,000
Tinnerman v. Comm'r, 448 Fed. Appx. 73 (D.C. Cir. 2012), *aff'g* T.C. Memo. 2010-150	Taxpayer appealed Tax Court's decision upholding IRS decision to proceed with collection and argued that he is not a taxpayer and has no liability to file Federal income tax returns	No	IRS	$8,000
Wheeler v. Comm'r, 446 Fed. Appx. 951 (10th Cir. 2011), *aff'g* T.C. Memo. 2010-188	Taxpayer appealed Tax Court's decision on redetermination of deficiency, additions to tax, and application of penalties; maintained proceedings primarily to delay collection	Yes	IRS	$6,000
Section 7482 (c)(4), FRAP Rule 38, or Other Authority Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments				
Provost, U.S. v., 109 A.F.T.R.2d (RIA) 1706 (E.D. Cal. 2012)	Taxpayer asserted frivolous arguments during a motion by the U.S. to strike his petition for declaratory judgment	Yes		

Table 9 Relief from Joint and Several Liability Under IRC § 6015

Case Citation	Issue(s)	*Pro Se*	Intervenor	Decision
Akopian v. Comm'r, T.C. Memo. 2011-237	6015(b), (f) (understatement)	No	No	IRS
Beach v. Comm'r, T.C. Memo. 2011-218	6015(g); effect of prior proceedings as a bar to relief	Yes	No	IRS
Bell v. Comm'r, T.C. Memo. 2011-152	6015(f) (underpayment)	No	No	Split
Gaitan, Javier v. Comm'r, T.C. Memo. 2012-3, T.C. Docket No. 19090-09 (This case was consolidated with T.C. Docket No. 21254-09)	6015(b), (c), (f) (understatement)	Yes	Yes	Split
Gaitan, Monica v. Comm'r, T.C. Memo. 2012-3, T.C. Docket No. 21254-09 (This case was consolidated with T.C. Docket No. 19090-09)	6015(f) (understatement)	No	No	IRS
Gallego v. Comm'r, T.C. Summ. Op. 2011-139	6015(f) (underpayment).	No	No	IRS
Garavaglia v. Comm'r, T.C. Memo. 2011-228, *appeal docketed*, No. 12-1444 (6th Cir. Apr. 13, 2012)	6015(b), (f) (understatement)	No	No	IRS
Gray v. Comm'r, 138 T.C. No. 13 (2012)	6015(f) (underpayment); effect of a second request for relief on Tax Court jurisdiction	Yes	No	TP
Haggerty v. Comm'r, T.C. Memo. 2011-284, *appeal docketed*, No. 12-60080 (5th Cir. Jan. 23, 2012)	6015(f) (underpayment)	No	No	IRS
Harbin v. Comm'r, 137 T.C. 93 (2011), *appeal dismissed*, No. 12-1952 (7th Cir. June 6, 2012)	6015(b) (understatement), (g); effect of prior proceedings as a bar to relief	No	Yes	TP
Hiramanek v. Comm'r, T.C. Memo. 2011-280, *appeal docketed*, No. 12-70325 (9th Cir. Feb. 1, 2012)	6015 (understatement); no joint return due to duress; relief granted under 66(c)	No	Yes	TP*
Jones v. Comm'r, 642 F.3d 459 (4th Cir. 2011) *rev'g and remanding* T.C. Docket No. 17359-08 (May 28, 2010)	Treas. Reg. 1.6015-5(b)(1) application of a two-year rule to claims for relief under section 6015(f) is a valid interpretation of section 6015(f)	No	No	IRS
Jones v. Comm'r, T.C. Summ. Op. 2011-135	6015(f) (underpayment)	No	Yes	TP
Karam v. Comm'r, T.C. Memo. 2011-230, *appeal docketed*, No. 11-2633 (6th Cir. Dec. 29, 2011)	6015 (f) (underpayment)	No	No	IRS
Koprowski v. Comm'r, 138 T.C. 54 (2012)	6015(g); effect of prior proceedings as a bar to relief	Yes	No	IRS
Ladehoff v. Comm'r, T.C. Summ. Op. 2012-15	6015 (b), (c), (f) (understatement)	Yes	No	IRS
LeBeau, U.S. v., 109 A.F.T.R.2d (RIA) 1369 (S.D.Cal. 2012)	District Court did not have jurisdiction to determine innocent spouse claim raised as a defense in a collection suit	Yes	No	IRS
Maluda v. Comm'r, 107 A.F.T.R.2d (RIA) 2588 (3d Cir. 2011), *aff'g* T.C. Memo. 2009-281	6015(f) (underpayment)	No	No	IRS
Melot, U.S. v., 109 A.F.T.R.2d (RIA) 1568 (D.N.M. 2012), *appeal dismissed*, No. 12-2055 (10th Cir. Aug. 1, 2012)	6015(f) (underpayment); substitute for return not joint return for 6015 purposes, relief not available under 66	Yes	No	IRS
Mercado v. Comm'r, T.C. Summ. Op. 2011-77	6015(f) (underpayment)	Yes	No	TP
Miles, U.S. v., 109 A.F.T.R.2d (RIA) 1602 (N.D. Cal. 2012)	District Court did not have jurisdiction to determine innocent spouse claim raised as a defense in a collection suit	No	No	IRS
Minihan v. Comm'r, 138 T.C. 1 (2012)	TP with separate interest in levied co-owned bank account is entitled to refund under section 6015(g)(1), if relief under 6015(f) is available	No	Yes	TP
Nunez v. Comm'r, T.C. Memo. 2012-121	6015(f) (underpayment)	Yes	Yes	IRS*
Pearce v. Comm'r, T.C. Summ. Op. 2011-98	6015(b), (c), (f) (understatement)	Yes	No	IRS
Pelikan v. Comm'r, 107 A.F.T.R.2d (RIA) 2441 (9th Cir. 2011), *aff'g* T.C. Docket No. 7607-06 (Mar. 12, 2009)	6015(b), (f) (understatement)	Yes	No	IRS
Pounds v. Comm'r, T.C. Memo. 2011-202	6015(c) (understatement)	No	Yes	TP*
Richard v. Comm'r, T.C. Memo. 2011-144	6015(c) (understatement)	No	Yes	TP

*The IRS agreed that the TP was entitled to relief with respect to at least one tax year in issue; only the intervenor was opposed.

Appendix Three

Table 9: Relief from Joint and Several Liability Under IRC § 6015

Case Citation	Issue(s)	*Pro Se*	Intervenor	Decision
Shanks v. Comm'r, T.C. Summ. Op. 2011-78	6015 (b), (c), (f) (understatement)	Yes	Yes	Split
Smith v. U.S., 101 Fed. Cl. 474 (2011), *aff'd*,110 A.F.T.R.2d (RIA) 5536 (Fed. Cir. 2012)	6015 (understatement); because court did not have jurisdiction over refund claim, it also did not have jurisdiction over innocent spouse defense	Yes	No	IRS
Smith v. Comm'r, T.C. Memo. 2011-119	6015(f) (underpayment)	No	No	Split
Sotuyo v. Comm'r, T.C. Summ. Op. 2012-27	6015(b), (c), (f) (understatement)	Yes	No	Split
Sriram v. Comm'r, T.C. Memo. 2012-91	6015(f) (underpayment)	No	No	IRS
Stennett-Bailey v. Comm'r, T.C. Memo. 2011-205	6015(f) (underpayment)	Yes	Yes	IRS
Suther v. Comm'r, T.C. Summ. Op. 2011-66	6015(f) (underpayment)	Yes	Yes	TP*
Torrisi v. Comm'r, T.C. Memo. 2011-235	6015(f) (underpayment)	No	No	Split
Waldron v. Comm'r, T.C. Memo. 2011-288	6015 (f) (underpayment)	No	No	Split
Ward v. Comm'r, T.C. Memo. 2011-253	6015 (b), (c), (f) (understatement)	Yes	Yes	IRS
Wickman v. Comm'r, T.C. Summ. Op. 2012-8	6015(f) (underpayment)	No	Yes	TP*
Zaher v. Comm'r, T.C. Memo. 2012-11	6015(f) (underpayment)	No	Yes	TP
Zhyrova v. Comm'r, T.C. Summ. Op. 2011-126	6015 (b), (c), (f) (understatement)	Yes	Yes	Split*

Table 10 Limitations on Assessment Under IRC § 6501

Case Citation	Issue(s)	Pro Se	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Balice, United States v., 108 A.F.T.R.2d (RIA) 5401 (D.N.J. 2011), *appeal docketed*, No. 12-2765 (3d Cir. June 25, 2012)	6501(a); TP's motion to dismiss based on untimely assessments denied; TP failed to allege dates when returns were filed	Yes	IRS
Beard v. Comm'r, 132 S. Ct. 2099 (April 30, 2012), *vacating and remanding* 633 F.3d 616 (7th Cir. 2011), *rev'g* T.C. Memo. 2009-184	6501(e)(1)(A); TPs' (H&W) overstatement of basis did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP
Day v. United States, 108 A.F.T.R.2d (RIA) 6266 (D. Colo. 2011)	6501(a); Court held statute of limitations on assessment does not apply to summonses; TP was not entitled to quash IRS summonses	No	IRS
Dingman v. Comm'r, T.C. Memo. 2011-116	6501(a); TP presented credible evidence that returns and payment were delivered to and processed by IRS more than 3 years before the date of assessment; IRS failed to provide evidence that TP had not effectively filed returns	Yes	TP
Gangi v. United States, 453 Fed. Appx. 255 (3d Cir. 2011), *aff'g* 107 A.F.T.R.2d (RIA) 1542 (D.N.J. 2011)	6501(a); Court held statute of limitations on assessment does not apply to summonses; TP was not entitled to quash IRS summonses	No	IRS
Garavaglia v. Comm'r, T.C. Memo. 2011-228, *appeal docketed*, No. 12-1438 (6th Cir. Apr. 13, 2012)	6501(c)(1); Fraudulent returns; tax may be assessed at any time	No	IRS
Gleason v. Comm'r, T.C. Memo. 2011-154	6501(c)(3); 6501(b)(3); Nonfiler; tax may be assessed at any time; substitutes for returns prepared by IRS do not start the period of limitations on assessment	Yes	IRS
Melot, United States v., 109 A.F.T.R.2d (RIA) 427 (D.N.M. 2012), *appeal dismissed*, No. 12-2055 (10th Cir. Aug. 1, 2012)	6501(c)(3); Nonfiler; tax may be assessed at any time	Yes	IRS
Norris v. Comm'r, T.C. Memo. 2011-161	6501(c)(1); IRS issued notice of deficiency for 1996 and 1998; TP (H) pleaded guilty to tax evasion for 1998, so TP (W) was estopped from denying filing a fraudulent return for 1998; IRS was unable to prove the 1996 return was fraudulent	No	Split
Paschall v. Comm'r, 137 T.C. 8 (2011)	6501(c)(3); TPs (H&W) filed Forms 1040 but TP (H) did not file Forms 5329; filing of Form 1040 did not start statute of limitations on assessment for the excise tax required to be reported on Form 5329; tax may be assessed at any time	No	IRS
Swanson v. Comm'r, 438 Fed. Appx. 582 (9th Cir. 2011), *aff'g* T.C. Memo. 2008-265	6501(e)(1)(A); Statute of limitations on assessment extended to six years because TPs (H&W) omitted from income more than 25% of the amount of gross income stated on their returns	No	IRS
Stone v. Comm'r, T.C. Summ. Op. 2011-128	6501(c)(1); Fraudulent returns; tax may be assessed at any time	Yes	IRS
Tyler, United States v., 109 A.F.T.R.2d (RIA) 1383 (E.D.Pa. 2012), *appeal docketed*, No. 12-2034 (3d Cir. Apr. 19, 2012)	6501(a); IRS assessed tax within three years after TP filed returns	No	IRS
Washington, United States v., 107 A.F.T.R.2d (RIA) 2647 (S.D. Tex. 2011), *appeal dismissed*, No. 12-20001 (5th Cir. Feb. 1, 2012)	6501(a); Court rejected TP's argument that IRS had an obligation to send informal notice of deficiency because TP's bankruptcy prohibited IRS from assessing tax; assessment was timely	No	IRS
Welch v. United States, 678 F.3d 1371 (Fed. Cir. 2012), *aff'g in part, rev'g in part* 98 Fed. Cl. 655 (2011)	6501(a); TPs (H&W) argued the IRS didn't properly mail notices of deficiency for 1992 and 1995, so statutes of limitations on assessment were not tolled for either year, and therefore assessments were untimely; IRS presented evidence of creation and mailing of the notice of deficiency for 1992 but not for 1995	No	Split
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C,E,F)			
Avenell v. Comm'r, T.C. Memo. 2012-32	6501(c)(1); IRS failed to prove by clear and convincing evidence that the TPs (H&W) filed false and fraudulent returns with intent to evade tax; statute of limitations barred the assessment	No	TP
Bemont Investments, LLC v. United States, 679 F.3d 339 (5th Cir. 2012)	6501(c)(10); Limitations period for assessment does not expire until one year after the material advisor has complied with the list maintenance requirements of 6112 for tax shelter transactions; material advisor's disclosure was insufficient so the limitations period had not expired	No	IRS

Appendix Three

Table 10: Limitations on Assessment Under IRC § 6501

Case Citation	Issue(s)	Pro Se	Decision
Browning v. Comm'r, T.C. Memo. 2011-261	6501(c)(1); IRS failed to prove by clear and convincing evidence that the TP filed false and fraudulent returns with intent to evade tax for 1995-1997, so the statute of limitations barred the assessment; IRS proved fraud for 1998-2000 returns, so the tax for those years can be assessed at any time	No	Split
Chai v. Comm'r, T.C. Memo. 2011-273	6501(c)(4); TP argued unsuccessfully that his consent to extend the assessment period was invalid on the grounds of undue influence by a partner; IRS assessed tax before the limitations period expired	No	IRS
City Wide Transit, Inc. v. Comm'r, T.C. Memo. 2011-279, *appeal docketed*, No. 12-1040 (2d Cir. Mar. 14, 2012)	6501(c)(1); 6501(c)(2); IRS failed to prove by clear and convincing evidence that the TP's accountant intended to evade tax or willfully attempted to defeat or evade employment taxes when he filed the TP's returns, so the statute of limitations barred the assessment	No	TP
DeVries v. Comm'r, T.C. Memo. 2011-185	6501(c)(3); Nonfiler; tax may be assessed at any time	Yes	IRS
Equipment Holding Co., LLC v. Comm'r, 439 Fed. Appx. 368 (5th Cir. 2011), *aff'g* No. 18737-07 (T.C. 2009), *cert. denied*, 132 S. Ct. 2122 (Apr. 30, 2012)	6501(e)(1)(A); TP's overstatement of did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP
Grapevine Imports, Ltd. v. United States, 132 S. Ct. 2099 (April 30, 2012), *vacating and remanding* 636 F.3d 1368 (Fed. Cir. 2011), *rev'g* 77 Fed. Cl. 505 (Fed. Cl. 2007)	6501(e)(1)(A); TP's overstatement of basis did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP
Home Concrete & Supply, LLC v. United States, 132 S. Ct. 1836 (Apr. 25, 2012), *aff'g* 634 F.3d 249 (4th Cir. 2011), *rev'g* 599 F.Supp.2d 678 (E.D.N.C. 2008)	6501(e)(1)(A); TP's overstatement of basis did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP
Intermountain Ins. Service of Vail, LLC v. Comm'r, 650 F.3d 691 (D.C. Cir. 2011), *vacated and remanded by* 132 S. Ct. 2120 (Apr. 30, 2012), *dismissed*, 2012 U.S. App. LEXIS 11811 (D.C. Cir., June 11, 2012)	6501(e)(1)(A); TP's overstatement of basis did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP
Licha v. Comm'r, T.C. Memo. 2011-275, *appeal docketed*, No. 12-72170 (9th Cir. July 9, 2012)	6501(e)(1)(A); Statute of limitations on assessment extended to six years because TPs (H&W) omitted from income more than 25% of the amount of gross income stated on their returns	Yes	IRS
Maris, United States v., 109 A.F.T.R.2d (RIA) 775 (D. Nev. 2012), *appeal docketed*, No. 12-15422 (9th Cir. Feb. 29, 2012)	6501(a); IRS assessment and collection actions were timely	Yes	IRS
May v. Comm'r, 137 T.C. 147 (2011), *appeal docketed*, No. 12-1829 (6th Cir. June 25, 2012)	6501(c)(1); Fraudulent returns; tax may be assessed at any time	Yes	IRS
Plotkin v. Comm'r, T.C. Memo. 2011-260, *appeal docketed*, No. 12-10620 (11th Cir. Feb. 6, 2012)	6501(c)(1); IRS proved by clear and convincing evidence that TP filed fraudulent returns; tax may be assessed at any time	No	IRS
R and J Partners v. Comm'r, 441 Fed. Appx. 271 (5th Cir. 2011), *aff'g* No. 7166-06 (T.C. 2009), *cert. denied*, 132 S. Ct. 2100 (Apr. 30, 2012)	6501(e)(1)(A); TP's overstatement of basis did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP
Salman Ranch, Ltd. v. Comm'r, 132 S. Ct. 2100 (Apr. 30, 2012), *vacating and remanding* 647 F.3d 929 (10th Cir. 2011), *rev'g* 2009 U.S. Tax Ct. LEXIS 44 (2009)	6501(e)(1)(A); TP's overstatement of basis did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP
Scott v. Comm'r, T.C. Memo. 2012-65	6501(c)(1); Fraudulent return; tax may be assessed at any time	No	IRS
UTAM, Ltd. v. Comm'r, 645 F.3d 415 (D.C. Cir. 2011), *vacated and remanded by* 132 S. Ct. 2100 (Apr. 30, 2012), *dismissed*, 2012 U.S. App. LEXIS 11813 (D.C. Cir., June 11, 2012)	6501(e)(1)(A); TP's overstatement of basis did not constitute an omission from gross income and did not trigger an extended six year statute of limitations	No	TP

Acronym Glossary — Annual Report to Congress 2012

Acronym	Definition
AARS	Appeals Account Resolution Specialist
ABA	American Bar Association
ACDS	Appeals Centralized Database System
ACH	Automated Clearinghouse
ACM	Appeals Case Memoranda
ACS	Automated Collection System
ACSS	Automated Collection System Support
ACTC	Additional Child Tax Credit or Advance Child Tax Credit
ADA	Americans With Disabilities Act
ADR	Alternative Dispute Resolution or Address Research
AEITC	Advanced Earned Income Tax Credit
AGI	Adjusted Gross Income
AIA	Anti-Injunction Act
AICPA	American Institute of Certified Public Accountants
AIS	Automated Insolvency System
AIQ	(IRS Office of) Advisory, Insolvency and Quality
AJCA	American Jobs Creation Act of 2004
AIMS	Audit Information Management System
ALE	Allowable Living Expenses
ALS	Automated Lien System
AM	Accounts Management
AMS	Accounts Management System
AMT	Alternative Minimum Tax
AMTAP	Accounts Management Taxpayer Assurance Program
ANMF	Automated Non Master File
ANPR	Advance Notice of Proposed Rulemaking
AO/SO	Appeals Officer or Settlement Officer
AOIC	Automated Offer In Compromise
APA	American Payroll Association or Administrative Procedure Act
APO/FPO	Army Post Office/Fleet Post Office
APS	Appeals Processing Service
AQC	Automated Questionable Credits
AQMS	Appeals Quality Management System
AQR	Automated Questionable Refund
ARAP	Accelerated Revenue Assurance Program
ARC	Annual Report to Congress
ARRA	America Recovery and Reinvestment Act
ASA	Average Speed of Answer
ASED	Assessment Statute Expiration Date

Acronym	Definition
ASFR	Automated Substitute for Return
ATAO	Application for Taxpayer Assistance Order
ATFRS	Automated Trust Fund Recovery System
ATIN	Adoption Taxpayer Identification Number
ATP	Abusive Transaction Program
AUR	Automated Underreporter
AWSS	Agency Wide Shared Services
BIR	Bureau of Internal Revenue
BMF	Business Master File
BOSS	Bond and Option Sales Strategy
BNA	Bureau of National Affairs
BPR	Business Performance Review
BRTF	Business Returns Transaction File
BSA	Bank Secrecy Act
BTA	Board of Tax Appeals
CAA	Certifying Acceptance Agent
CADE2	Customer Account Data Engine 2
CAF	Centralized Authorization File
CAP	CAWR Automated Program
CARE	Customer Assistance, Relationships & Education
CAS	Customer Account Services
CAWR	Combined Annual Wage Reporting
CBO	Congressional Budget Office
CBPP	Center on Budget & Policy Priorities
CBRS	Currency & Banking Retrieval System
CC	Chief Counsel (Office of)
CCB	Check Claims Branch
CCISO	Cincinnati Campus Innocent Spouse Operations
CCP-LU	Centralized Case Processing
CDP	Collection Due Process
CDPTS	Collection Due Process Tracking System
CDE	Compliance Data Environment
CDW	Compliance Data Warehouse
CEAP	Correspondence Examination Assessment Project
CEAS	Correspondence Examination Automation Support
CFf	Collection Field Function
CFIF	Check Forgery Insurance Fund
CI	Criminal Investigation (Division)
CIP	Compliance Initiative Project

Appendix Four

Appendix Four

Acronym	Definition
CIQMS	Complex Interest Quality Management System
CIS	Correspondence Imaging System
CLD	Communications, Liaison and Disclosure
CNC	Currently Not Collectible
COBRA	Consolidated Omnibus Budget Reconciliation Act
CODI	Cancellation Of Debt Income
COIC	Centralized Offer In Compromise
COTR	Contract Officer Technical Representative
CONOPS	Concept of Operations
CPE	Continuing Professional Education
CPS	Collection Process Study
CQMS	Collection Quality Management System
CRIS	Compliance Research Information System
CSCO	Compliance Services Collection Operations
CSED	Collection Statute Expiration Date
CSI	Campus Specialization Initiative
CSO	Communications and Stakeholder Outreach
CSR	Customer Service Representative
CTC	Child Tax Credit
DA	Disclosure Authorization
DAC	Disability Access Credit
DART	Disaster Assistance Review Team
DATC	Doubt As To Collectibility
DATL	Doubt As To Liability
DCI	Data Collection Instrument
DCIA	Debt Collection Improvement Act (of 1996)
DCCP	Debit and Credit Card Payment
DD	Direct Deposit
DDb	Dependent Data Base
DDIA	Direct Deposit Installment Agreement
DDP	Daily Delinquency Penalty
DFO	Designated Federal Official
DHS	Department of Homeland Security
DI	Desktop Integration or Debt Indicator
DIF	Discriminant Income Function
DJA	Declaratory Judgment Act
DLN	Document Locator Number
DMF	Death Master File
DOD	Department of Defense
DOJ	Department of Justice
DoMA	Defense of Marriage Act

Acronym	Definition
DPC	Designated Payment Code
DSO	Designated School Official
EA	Enrolled Agent
EAC	Examination Activity Code
EAJA	Equal Access to Justice Act
EAR	Electronic Account Resolution
EBE	Employee Business Expense
EBT	Electronic Benefits Transfer
ECS	Enterprise Collections Strategy
EGTRRA	Economic Growth and Tax Relief Reconciliation Act (of 2001)
EFDS	Electronic Fraud Detection System
EFS	Enterprise Fax Storage
EFTPS	Electronic Federal Tax Payment System
EFW	Electronic Funds Withdrawal
EIC	Earned Income Credit
EIN	Employer Identification Number
EITC	Earned Income Tax Credit
ELMS	Enterprise Learning Management System
ELS	Electronic Lodgment Service
ERIS	Enforcement Revenue Information System
EO	Exempt Organization
EP	Employee Plans
EQRS	Embedded Quality Review System
ERIS	Enforcement Revenue Information System
ERO	Electronic Return Originator
ERISA	Employee Retirement Income Security Act
ERSA	Employee Retirement Savings Account
ES	Estimated Tax Payments
ESA	Economic Stimulus Act
ESL	English as a Second Language
ESOP	Employee Stock Ownership Plan
ESP	Economic Stimulus Payment
ETA	Effective Tax Administration
ETACC	Electronic Tax Administration Advisory Committee
ETARC	Electronic Tax Administration and Refundable Credits
ETLA	Electronic Tax Law Assistance
FA	Field Assistance
FAFSA	Free Application for Financial Student Aid
FATCA	Foreign Account Tax Compliance Act
FBAR	Foreign Bank Account Report
FBU	Federal Benefits Unit

Acronym	Definition
FCR	Federal Case Registry
FCRA	Fair Credit Reporting Act
FDCPA	Fraud Detection Center
FDC	Fair Debt Collection Practices Act
FDIC	Federal Deposit Insurance Corporation
FEIE	Foreign Earned Income Exclusion
FEMA	Federal Emergency Management Agency
FFCD	Future Field Collection Design
FFFF	Free File Fillable Forms
FICA	Federal Insurance Contribution Act
FIRPTA	Foreign Investment in Real Property Tax Act
FMV	Fair Market Value
FMS	Financial Management Service
FOIA	Freedom Of Information Act
FPAA	Final Partnership Administrative Adjustment
FPLP	Federal Payment Levy Program
FRA	Federal Records Act
FSLA	Fair Labor Standards Act
FSA	Facilitated Self-Assistance
FSRP	Facilitated Self-Assistance Research Project
FTA	First-Time Abatement or Federal Tax Application
FTC	Federal Trade Commission or Foreign Tax Credit
FTD	Federal Tax Deposit or Failure To Deposit
FTE	Full-Time Equivalent
FTF	Failure To File
FTHBC	First-Time Homebuyer Credit
FTI	Federal Tax Information
FTL	Federal Tax Lien
FTP	Failure To Pay
FTS	Fast Track Settlement
FUTA	Federal Unemployment Tax
FY	Fiscal Year
GCCF	Gulf Coast Claims Facility
GCI	Geographic Coverage Initiative
GCM	General Counsel Memorandum
GLD	Governmental Liaison and Disclosure
GO	Government Entities
GAO	Government Accountability Office or General Accounting Office
HCTC	Health Coverage Tax Credit
HERA	Housing and Economic Recovery Act
HCCH	Hague Conference on Private International Law

Acronym	Definition
IA	Installment Agreement
IAT	Integrated Automation Technologies
ICAS	Internet Customer Account Services
ICP	Integrated Case Processing
ICS	Integrated Collection System
IDAP	IDRS Decision Assisting Program
IDRM	Information Reporting and Document Matching
IDFP	IRS Directory for Practitioners
IDRS	Integrated Data Retrieval System
IDS	Inventory Delivery System
IFC	International Finance Corporation
IITA	International Individual Taxpayer Assistance Team
IMD	Internal Management Document
IMF	Individual Master File
IMRS	Issue Management Resolution System
IPM	Integrated Production Model
IPO	ITIN Program Office
IPOC	International Planning and Operations Council
IP PIN	Identity Protection Personal Identification Number
IPSU	Identity Protection Specialized Unit
IRB	Internal Revenue Bulletin
IRC	Internal Revenue Code
IRDM	Information Reporting Document Matching
IRM	Internal Revenue Manual
IRMF	Information Returns Master File
IRP	Information Returns Processing
IRPTR	Information Returns Processing Transcript Requests
IRS	Internal Revenue Service
IRSAC	Internal Revenue Service Advisory Council
IRSN	Internal Revenue Service Number
ITA	Interactive Tax Assistance
ITAAG	Identity Theft Assessment and Action Group
ITAR	Identity Theft Assistance Request
ITIN	Individual Taxpayer Identification Number
JCT	Joint Committee on Taxation
JGTRA	Jobs and Growth Tax Relief Reconciliation Act (of 2003)
JOC	Joint Operations Center
LB&I	Large Business and International Operating Division
LCCI	Last Chance Compliance Initiative
LCTU	Large Corporation Technical Unit
LEM	Law Enforcement Manual

Appendix Four

Acronym	Definition
LEP	Limited English Proficiency
LIF	Low Income Filter
LIHTC	Low Income Housing Tax Credit
LILO	Lease-In Lease-Out
LITC	Low Income Taxpayer Clinic
LLC	Limited Liability Company
LLP	Limited Liability Partnership
LOS	Level of Service
LP	Limited Partnership
LSB	Language Services Branch
LTA	Local Taxpayer Advocate
M&P	Media and Publications
MAGI	Modified Adjusted Gross Income
MFDRA	Mortgage Forgiveness Debt Relief Act
MFT	Master File Tax
MIRSA	My IRS Account Application
MITS	Modernization and Information Technology Services
MLI	Multilingual Initiative or Most Litigated Issue
MWP	Making Work Pay Credit
NAEA	National Association of Enrolled Agents
NCOA	National Change of Address
NEH	Non-Economic Hardship
NFTL	Notice of Federal Tax Lien
NMF	Non-Master File
NNA	National Notary Association
NOD	Notice of Deficiency
NPRC	National Payroll Reporting Consortium
NPS	National Print Site
NQRS	National Quality Review System
NRP	National Research Program
NTA	National Taxpayer Advocate
OAR	Operations Assistance Request
OBRA	Omnibus Budget Reconciliation Act (of 1990)
OD	Operating Division
OIC	Offer in Compromise
OECD	Organisation for Economic Co-Operation and Development
OMB	Office of Management and Budget
OMM	Operation Mass Mail
OPERA	Office of Program Evaluation, Research, & Analysis
OPI	Office of Penalty and Interest Administration or Over the Phone Interpreter

Acronym	Definition
OSI	Office of Servicewide Interest
OPR	Office of Professional Responsibility
OSP	Office of Servicewide Penalties
OTA	Office of Tax Analysis
OTBR	Office of Taxpayer Burden Reduction
OTC	Office of Taxpayer Correspondence
OTP	Office of Tax Policy
OUO	Official Use Only
OVC	Office for Victims of Crime
OVCI	Offshore Voluntary Compliance Initiative
OVD	Offshore Voluntary Disclosure
OVDI	Offshore Voluntary Disclosure Initiative
OVDP	Offshore Voluntary Disclosure Program
PCA	Private Collection Agency
PCAOB	Public Company Accounting Oversight Board
PCI	Potentially Collectible Inventory
PDC	Private Debt Collection
PEO	Professional Employer Organization
PFA	Pre-Filing Agreement
PGLD	Privacy, Governmental Liaison and Disclosure (Office of)
PIC	Primary Issue Code
PNI	Potential New Inventory
PLR	Private Letter Ruling
POA	Power Of Attorney
POP	Phone Optimization Project
PPA	Pension Protection Act (of 2006)
PPACA	Patient Protection and Affordable Care Act
PPBR	Printing and Postage Budget Reduction
PPIA	Partial Payment Installment Agreement
PPS	Practitioner Priority Service
PRA	Paperwork Reduction Act
PRP	Problem Resolution Program
PRWORA	Personal Responsibility and Work Opportunity Reconciliation Act (of 1996)
PSC	Philadelphia Service Center
PSP	Payroll Service Provider
PREA	Premature Referral and Acceptance
PTIN	Preparer Tax Identification Number
PwC	PricewaterhouseCoopers
PY	Processing Year
QBU	Qualified Business Unit

Acronym	Definition
QETP	Questionable Employment Tax Practices
QRP	Questionable Refund Program
RA	Revenue Agent or Reporting Agent
RAC	Refund Anticipation Check
RAL	Refund Anticipation Loan
RCA	Reasonable Cause Assistant
RCP	Reasonable Collection Potential
RGS	Report Generating Software
RICS	Return Integrity and Correspondence Services
RO	Revenue Officer or Responsible Officer
ROFT	Record of Federal Tax Liability
ROI	Return on Investment
ROTERS	Records of Tax Enforcement Results
RPS	Revenue Protection Strategy
RRA 98	(Internal Revenue Service) Restructuring and Reform Act of 1998
RPC	Return Preparer Coordinator
RPS	Revenue Protection Strategy
RPP	Return Preparer Program
RRP	Return Review Program
RSED	Refund Statute Expiration Date
RTTS	Real-Time Tax System
SA	Systemic Advocacy
SAMS	Systemic Advocacy Management System
SAR	Strategic Assessment Report
SARP	State Audit Report Program
SBA	Small Business Administration
SBDC	Small Business Development Center
SB/SE	Small Business/Self Employed Operating Division
SEC	Securities and Exchange Commission
SEP	Special Enforcement Program
SERP	Servicewide Electronic Research Program
SEVP	Student and Exchange Visitor Program
SFR	Substitute for Return
SL	Stakeholder Liaison
SLA	Service Level Agreement
SNOD	Statutory Notice of Deficiency
SOI	Settlement Officer
SOI	Statistics of Income
SP	Submission Processing
SPC	Submission Processing Center(s)

Acronym	Definition
SPDER	Office of Servicewide Policy, Directives, and Electronic Research
SPEC	Stakeholder Partnerships, Education & Communication
SPOC	Single Point of Contact
SSA	Social Security Administration
SSI	Supplemental Security Income
SSMC	Services, Support and Modernization Committee
SSN	Social Security Number
STC	Student Tax Clinic
STO	Student Tuition Organization
SVC	Stored Value Card
TAB	Taxpayer Assistance Blueprint
TAC	Taxpayer Assistance Center
TACT	Taxpayer Communications Taskgroup
TAD	Taxpayer Advocate Directive
TAMIS	Taxpayer Advocate Management Information System
TAMRA	Technical and Miscellaneous Revenue Act (of 1988)
TAO	Taxpayer Assistance Order
TAP	Taxpayer Advocacy Panel
TAS	Taxpayer Advocate Service
TBOR	Taxpayer Bill of Rights
TC	Transaction Code
TCE	Tax Counseling for the Elderly
TDA	Taxpayer Delinquent Account
TDRA	Tip Rate Determination Agreement
TDI	Taxpayer Delinquent Investigation
TE	Tax Examiner or Tax Exempt
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
TEC	Taxpayer Education and Communication
TE/GE	Tax Exempt & Government Entities Operating Division
TEFRA	Tax Equity and Fiscal Responsibility Act
TFP	Tax Forms & Publications
TFRP	Trust Fund Recovery Penalty
TGR	Total Gross Receipts
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
TIPRA	Tax Increase Prevention and Reconciliation Act (of 2005)
TOP	Treasury Offset Program
TOS	Terms of Service
TPE	Taxpayer Education
TPI	Total Positive Income

Appendix Four

Acronym	Definition
TPNC	Taxpayer Notice Code
TPP	Third-Party Payer
TPPA	Third Party Payroll Agent
TPU	Taxpayer Protection Unit
TRA	Tax Reform Act
TRHCA	Tax Relief and Health Care Act (of 2006)
TTB	(Alcohol and Tobacco) Tax and Trade Bureau
TY	Tax Year
UAA	Undeliverable As Addressed
UAL	Uniform Acknowledgement Letter
UCR	Uniform Call Routing
UDOC	Uniform Definition of a Child
ULC	Universal Location Code
UOU	Universal Postal Union
URF	Unidentified Remittances File
URP	Underreporter
USPS	United States Postal Service
USPTO	United States Patent and Trademark Office
UWR	Uniform Work Request
VAT	Value Added Tax
VCP	Voluntary Compliance Program
VFTF	Virtual Face-to-Face
VITA	Volunteer Income Tax Assistance
VSD	Virtual Service Delivery
VTO	Virtual Translation Office
W & I	Wage and Investment Operating Division
WFTRA	Working Families Tax Relief Act
WIRA	Wage and Investment Research & Analysis
WO	Whistleblower Office
XSF	Excess Collection File

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Appendix Five

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Appendix Five

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