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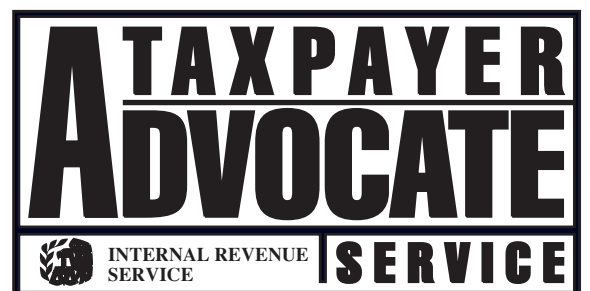
TAXPAYER

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ADVOCATE

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FY 2002 ANNUAL REPORT TO CONGRESS





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*This Report is dedicated to  
Etoile Beller  
and  
Keith Restaino  
whose concern for taxpayers  
and personal courage inspired  
everyone they met.*

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**Honorable Members of Congress,**

It is my pleasure to submit to you for your review the National Taxpayer Advocate’s 2002 Annual Report to Congress. Throughout this report, you will note an emphasis on taxpayer rights. This emphasis is intentional. With the increase in collection and other compliance activities and the increased use of automated processes to efficiently handle volumes of taxpayer correspondence and cases, the question arises whether these initiatives will undermine taxpayer protections and the confidence taxpayers have in the U.S. tax system.

Over the last year, the Internal Revenue Service (IRS) has made significant progress on a number of fronts – launching initiatives involving corporate technical tax shelters, abusive tax schemes, and off-shore accounts; improving its toll-free telephone service; and even eliminating some of the offer-in-compromise backlog. The IRS has also been more responsive to taxpayer and tax professional groups, including them in discussions *before* final decisions are made. The Taxpayer Advocate Service is pleased with these developments even as we acknowledge that there is much more to be done.

Surely, taxpayers will be pleased to read or hear in the media about the IRS’s continuing efforts to identify and collect from taxpayers who are actively avoiding (even evading) reporting and payment of their correct tax liabilities. But will they continue to be pleased when they themselves cannot reach the IRS to discuss a problem, or can’t locate the right person to help them, or receive confusing notices that result in the denial of a tax credit without access to the United States Tax Court, or have their offer-in-compromise rejected because the IRS is not available to talk with them on the phone in order to clarify a question? The difficulty taxpayers and IRS employees face in navigating the IRS is the number one “Most Serious Problem.”

The IRS will be tempted to rely on automated processes as it has more social policy programs heaped on it, even as it is criticized for inadequately implementing its current programs (e.g., the earned income tax credit). These initiatives drive the IRS to use devices such as math error authority (where the taxpayer is summarily assessed a tax and must request abatement in order to obtain access to the Tax Court) or “combination letters” (where the taxpayer receives a request from an examination or offer-in-compromise employee for additional information simultaneous with a less than clear notice of appeal rights). We address both of these issues in the “Most Serious Problems” section of this report. We also submit for your consideration a legislative proposal about math error authority.

As a member of the IRS senior leadership, I am very cognizant of the need for the IRS to use its available resources wisely. Clearly, the IRS should use automated services where effective, efficient and appropriate. The Taxpayer Advocate Service is not advocating for face-to-face contact with all taxpayers, or even the majority of them. We will, however,

continue to point out that effective tax administration is a two-way street – the IRS must be open for business for all taxpayers, available for them to communicate – whether in person (Taxpayer Assistance Centers), in writing (prompt processing of and response to correspondence; clear and understandable notices); via telephones (toll-free, EITC, automated underreporter, offer-in-compromise), or through the internet (IRS employee and program locator; electronic delivery of transcripts and employer identification numbers; electronic tax law assistor). All of these issues are discussed in this report as aspects of the Most Serious Problems encountered by taxpayers.

The concept of “access” is fundamental to universal achievement of taxpayer rights. For taxpayers to feel that they should comply with their tax obligations and tax responsibilities, taxpayers must feel that they have –

- ◆ Access to information,
- ◆ Access to the IRS,
- ◆ Access to the Taxpayer Advocate Service,
- ◆ Access to representation, and
- ◆ Access to return preparation.

#### *Access to information*

Taxpayers must not only be able to find out what is happening with their own accounts; they should also know what the IRS is doing to resolve systemic as well as specific taxpayer problems. Greater transparency is needed in the tax system – the “Most Serious Problems” section of this report is the Taxpayer Advocate Service’s attempt to shine some light on the operations of the IRS. We are pleased with the responses we received from the IRS about each problem and appreciate the Service’s willingness to engage in an open dialogue about very difficult issues.

In order to achieve a truly first class tax system, the IRS needs to have both the freedom to try innovative solutions and the courage to admit that it has failed, without fearing that it will be “punished” in the next appropriations cycle. It must invest in fundamental research about taxpayer behavior *before* it designs compliance systems. Beyond simply convening focus groups and conducting surveys, the IRS must test new systems on taxpayers (the users) and observe their experiences and reactions. The Service must communicate its initiatives, goals, plans, and direction clearly and forcefully, and Congress as well as the taxpaying public must exercise restraint and patience while the IRS implements complex programs. Patience will not, however, be exercised if Congress and taxpayers do not receive reliable and timely information. This is a tall order, but in the 21st century it is an absolutely necessary one.



*Access to the IRS*

Taxpayers must be able to determine who in the IRS they need to talk to about their problems or their questions and they must be able to locate those employees. They must be able to determine the management chain of command and locate the program area for their concerns. Once they find the right program and person, they must receive a clear response. Without such access, taxpayers will be unable to avail themselves of their rights, regardless of how many protections Congress enacts. In this report we identify several issues relating to access to the IRS, including the inability to navigate the IRS and the operation of the Taxpayer Assistance Centers.

*Access to the Taxpayer Advocate Service*

Taxpayers must know that the Taxpayer Advocate Service (TAS) exists and what its mission is in order to avail themselves of its assistance. TAS must provide taxpayers with timely service, correct responses, and effective advocacy. The Taxpayer Advocate Service must live up to its role as the conscience of the IRS in terms of specific taxpayer cases and systemic problems.

The Taxpayer Advocate Service is often the taxpayer's last chance for problem resolution. As such, taxpayers must be confident that their communications with TAS are not routinely shared with the rest of the IRS. In this report, we discuss several legislative enhancements to the Office of the Taxpayer Advocate, including the creation of an independent Counsel to the National Taxpayer Advocate and authority for the National Taxpayer Advocate to intervene in federal tax litigation as an *amicus curiae*, as well as expanded confidentiality provisions.

*Access to Representation*

It is a truism that taxpayers fare better with problem resolution and avail themselves of taxpayer rights when they have representation. The discussion of *pro se* representation in the "Most Litigated Issues" section of this report demonstrates the truth behind this truism. Not all of the 59 percent of taxpayers who represent themselves before the United States Tax Court (and by extension, the Internal Revenue Service) do so willingly. Many simply cannot afford the cost of representation.

Funding for low income taxpayer clinics under IRC § 7526 and the provision of free or nominal fee tax representation is a significant step toward a more equitable system. But funding alone will not provide representation – what is required is the dedication of many volunteer tax professionals to undertake these cases in addition to their "regular" work.

Four years ago I wrote,

We are a nation of laws. And if those laws are only within reach of the rich or the powerful, then we become a nation of laws for the few and injustice for the many. This is not a recipe for a healthy democratic society.

This oligarchy of justice also distorts the quality of the law. When the man or woman on the street is denied access to the courts, then the [decisions] handed down by the courts reflect the problems of the privileged few. Law loses its relevance to the problems of everyday life and ultimately most of the populace loses its respect for law.<sup>1</sup>

I believe we are seeing an erosion in the confidence and compliance of the taxpayer on the street with the tax system because the tax system has lost its relevance to that taxpayer. It has become, in both its processes and its substance, the domain of those who have access to representation. As National Taxpayer Advocate, I will be committing the resources of my office toward increasing taxpayers' access to representation by individually and systemically encouraging tax professionals to dedicate at least two percent of their professional time to *pro bono* representation of taxpayers who cannot afford representation.

#### *Access to Preparation*

The Office of the Taxpayer Advocate supports the creation of an IRS-administered grant program for free tax preparation for low income taxpayers. We do not want funding of tax preparation to dilute the funding for *pro bono* representation in tax controversies, nor do we want such funding to siphon off programs that are already providing free tax preparation such as Volunteer Income Tax Assistance (VITA) sites.

In this report, we submit a legislative proposal for the regulation of unenrolled return preparers. We note that there are several factors that drive low income taxpayers to pay for tax preparation, including:

- ◆ Inconvenient location or hours of VITA sites;
- ◆ Lack of bank accounts for direct deposit of refunds;
- ◆ Need or desire for immediate cash; and
- ◆ Inability to prepare one's own taxes due to limited language, literacy, or computer skills.

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<sup>1</sup>Nina E. Olson, *Why Pro Bono Service?*, *The Virginia Lawyer*, Vol. 47, No. 5 at 19 (December 1998).



The grant program I envision would require programs to address these obstacles. Specifically, grants would be made for demonstration projects as seed money to attract other grants, much like the awards being made under the Violence Against Women Act and welfare to work legislation. The grant would be issued to an organization that is serving as the lead for a coalition of groups, including banks, city or state economic development agencies or health and human services offices, welfare groups, and other social service organizations. The programs would target a significant number of taxpayers (either in a concentrated urban area or more dispersed throughout a larger geographic area).

These coalitions would not only provide free tax preparation, but they would support the IRS's goal (and need) to have returns electronically filed. However, electronic filing alone is not sufficient to draw taxpayers to these sites – taxpayers must be able to open low fee accounts in which refunds may be electronically deposited. Thus, the coalitions must include banking partners.

Many low income taxpayers receive all or part of their refund through refund anticipation loans (RALs) or pay a fee for a third party to receive a direct deposit of their tax refund check. RALs will largely disappear *when* the IRS is able to return refunds within two to four days *if* low income taxpayers are *banked*. If these taxpayers do not have some sort of account in which to receive a direct deposit, then RALs will never go away. Without banking, there will always be customers for the product.

No matter how successful Volunteer Income Tax Assistance, Tax Counseling for the Elderly, or a new low income taxpayer preparation grant program is, these initiatives will not make a dent in tax preparation for the 19 million taxpayers eligible for the Earned Income Tax Credit (EITC). Over one half of these taxpayers pay a professional preparer to obtain what is essentially a federal benefit transfer. No other means-tested federal benefit program requires its beneficiaries to pay an application fee for the benefit. Yet this is essentially what we require of EITC recipients.

The next few years provide Congress, consumer and low income taxpayer advocates, and commercial tax preparers with an opportunity to do some creative thinking about how to deliver the EITC to eligible low income taxpayers for free or for a nominal charge. It is an opportunity to develop innovative partnerships to educate low income taxpayers about the tax system and provide them with the basics of financial literacy. Engagement and education will also bring about better compliance with the tax system's often inexplicable rules.



With these comments as a backdrop, I am pleased to submit to you the National Taxpayer Advocate's FY 2002 Annual Report to Congress. This report is the product of many Taxpayer Advocate Service employees who worked hard and wrote thoughtfully, and I am grateful for their efforts. I also wish to thank the labors of the many IRS employees (including the IRS research staff), taxpayers, and tax professionals who responded to our questions quickly and insightfully. In the dialogue between the Taxpayer Advocate Service and the IRS, you will see an attempt to provide a window to the workings of the IRS, even where we disagree as to the proper course of action. I believe we have made a good start toward greater transparency in IRS operations.

Respectfully Submitted,



Nina E. Olson  
National Taxpayer Advocate  
31 December 2002



## TABLE OF CONTENTS

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### PREFACE

<b>THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS</b> . . . . .	<b>2</b>
<b>INTRODUCTION</b> . . . . .	<b>2</b>
<b>NAVIGATING THE IRS</b> ( <i>concerns individual &amp; business taxpayers</i> ) . . . . .	<b>7</b>
<b>PROCESSING OF OFFER-IN-COMPROMISE CASES</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>15</b>
<b>MATH ERROR AUTHORITY</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>25</b>
<b>IRS INFORMATION REPORTING PROGRAM</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>32</b>
<b>PROCESSING CLAIMS FOR REFUND</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>42</b>
<b>EITC ELIGIBILITY DETERMINATION CAN BE MADE LESS BURDENSOME</b> ( <i>all EITC issues concern individual taxpayers</i> ) . . . . .	<b>47</b>
<b>PROCEDURES FOR EXAMINING EITC CLAIMS CAUSE HARDSHIP         AND INFRINGE ON APPEAL RIGHTS</b> . . . . .	<b>55</b>
<b>LACK OF RESPONSE DURING EITC EXAMS</b> . . . . .	<b>64</b>
<b>IRS OVERSIGHT OF EITC RETURN PREPARERS CAN BE IMPROVED</b> . . . . .	<b>69</b>
<b>THE LENGTH OF EITC AUDITS CONTRIBUTES TO TAXPAYER CONCERNS</b> . . . . .	<b>75</b>
<b>EITC RECERTIFICATION COMPOUNDS TAXPAYER BURDEN</b> . . . . .	<b>81</b>
<b>LANGUAGE &amp; CULTURAL BARRIERS IMPACT TAXPAYER COMPLIANCE</b> ( <i>individual taxpayers</i> ) . . . . .	<b>88</b>
<b>FREE U.S. INDIVIDUAL INCOME TAX RETURN PREPARATION</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>95</b>
<b>ACCESS TO ACS (AUTOMATED COLLECTION SYSTEM)</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>104</b>
<b>COLLECTION DUE PROCESS</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>110</b>
<b>AWARENESS AND UNDERSTANDING OF FEDERAL TAX DEPOSITS</b> ( <i>business taxpayers</i> ) . . . . .	<b>116</b>
<b>TOLL-FREE ACCURACY</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>122</b>
<b>TOLL-FREE LEVEL OF SERVICE (ACCESS)</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>125</b>
<b>REFUND INQUIRIES</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>131</b>
<b>OBTAINING EMPLOYER IDENTIFICATION NUMBERS (EINS)</b> ( <i>business taxpayers</i> ) . . . . .	<b>135</b>
<b>DELAY IN RECEIVING REQUESTED DOCUMENTS</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>140</b>
<b>MISAPPLIED/LOST PAYMENTS</b> ( <i>individual &amp; business taxpayers</i> ) . . . . .	<b>147</b>
<b>RELIEF FROM JOINT &amp; SEVERAL LIABILITY (FOLLOW-UP REPORT ON FY 2001 PROBLEM)</b> ( <i>individual taxpayers</i> ) . . . . .	<b>150</b>
<b>THE NATIONAL TAXPAYER ADVOCATE'S LEGISLATIVE RECOMMENDATIONS</b> . . . . .	<b>156</b>
<b>INTRODUCTION</b> . . . . .	<b>156</b>
<b>KEY RECOMMENDATIONS</b> . . . . .	<b>160</b>
<b>ATTORNEY FEES IN NONPHYSICAL PERSONAL INJURY CASES</b> . . . . .	<b>160</b>

MARRIED COUPLES AS BUSINESS CO-OWNERS . . . . .	172
MATH ERROR AUTHORITY . . . . .	185
THE OFFICE OF THE TAXPAYER ADVOCATE . . . . .	198
REGULATION OF FEDERAL TAX RETURN PREPARERS . . . . .	216
CHILDREN'S INCOME . . . . .	231
ADDITIONAL RECOMMENDATIONS . . . . .	243
CHANGE OF WITHHOLDING PROCEDURE UNDER IRC § 3402 (I) . . . . .	243
COLLECTION DUE PROCESS . . . . .	244
DE MINIMIS EXCEPTION TO PASSIVE LOSS AND CREDIT LIMITATIONS . . . . .	245
ELECTION TO BE TREATED AS AN S CORPORATION . . . . .	246
LEVY ON MUTUAL FUNDS INCLUDING MONEY MARKET FUNDS . . . . .	247
THE MOST LITIGATED TAX ISSUES . . . . .	248
INTRODUCTION . . . . .	248
<i>PRO SE</i> LITIGATION . . . . .	252
NONFILER/UNREPORTED & UNDERREPORTED INCOME . . . . .	258
COLLECTION DUE PROCESS . . . . .	272
TRADE OR BUSINESS EXPENSES . . . . .	283
VALUATION . . . . .	304
EARNED INCOME TAX CREDIT (EITC) . . . . .	312
ABUSIVE TRUSTS . . . . .	333
ITEMIZED DEDUCTIONS . . . . .	344
CAPITAL GAIN AND LOSS . . . . .	350
CIVIL FRAUD PENALTY . . . . .	360
JOINT AND SEVERAL LIABILITY . . . . .	367
BARRED REFUNDS . . . . .	380
TAXPAYER ADVOCATE SERVICE CASE ADVOCACY AND SYSTEMIC ADVOCACY . . . . .	386
APPENDICES	
CRITERIA USED TO RANK MOST SERIOUS PROBLEMS	
APPENDIX A . . . . .	400
TAMIS LIST OF TAXPAYER PROBLEMS	
APPENDIX B . . . . .	402
TAS DIRECTORY	
APPENDIX C . . . . .	403

## MOST SERIOUS PROBLEMS

### ENCOUNTERED BY TAXPAYERS

#### INTRODUCTION

The scope and complexity of the U.S. tax code make it virtually certain that U.S. taxpayers will face procedural, technical and bureaucratic obstacles in meeting their tax obligations. Although the Internal Revenue Service has consistently and commendably sought to ease the process for all taxpayers, each tax season brings new problems. Some older problems stubbornly resist solution.

The Taxpayer Advocate Service (TAS) is responsible for helping to resolve and prevent such problems at the specific taxpayer and systemic levels. These dual roles complement each other: taxpayer disputes with the IRS alert us to larger issues, while our efforts to deal with these matters systemically can improve the IRS and reduce specific taxpayer problems.

The IRS has recently refocused its compliance initiative, the ongoing program to ensure that all taxpayers pay the correct amount of tax. This effort includes additional focus on abusive tax shelters, trusts and other schemes. The Taxpayer Advocate Service fully supports these efforts. We believe that fairness, justice and personal responsibility are building blocks of an equitable and effective tax system. However, it is equally vital that the problems of law-abiding taxpayers, who do their best to cope with an often frustrating tax code, are handled promptly and fairly under IRS policies and procedures.

Many individuals and businesses come to TAS for help because the IRS has not provided prompt or appropriate assistance through normal channels.<sup>1</sup> Just navigating the bureaucracy can be exhausting and time-consuming; indeed, that particular issue tops our list of the Most Serious Problems Encountered by Taxpayers in the 2002 fiscal year.

The Internal Revenue Code requires the National Taxpayer Advocate to discuss at least 20 of these serious issues in each Annual Report to Congress; this year we have analyzed and commented on 22 of them.<sup>2</sup> The list includes familiar concerns such as late refunds and the accuracy of information dispensed over IRS toll-free customer service lines. We have also considered more complex issues including offers in compromise and the lengthy audits facing some taxpayers who claim the Earned Income Tax Credit (EITC). We have listed one item, Claims for Relief from Joint and Several Liability, that dropped off the list submitted for FY 2001. Because this issue is of great interest to Congress, practitioners, and taxpayers alike, we included a detailed discussion of IRS progress on this program.

<sup>1</sup> In FY 2002, TAS closed 34,015 economic hardship cases and 196,261 systemic hardship cases.

<sup>2</sup> IRC §7803(c)(2)(B)(ii)(III).

**SOLUTIONS TO TAXPAYER PROBLEMS**

The National Taxpayer Advocate believes that none of the problems discussed in this section is too large to overcome or too small to ignore. Further, all 22 issues can and should be resolved with the help of the IRS leadership, and in some cases, Congress. It is significant to note that the resolution of issues often requires more resources – either monetary or technological.

The National Taxpayer Advocate is aware that Congress and taxpayers alike may be skeptical of the IRS’ perennial plea for more resources. She is not advocating that money be simply thrown at a problem. She is, however, suggesting that Congress consider the impact of placing more and more programs and requirements upon the IRS, while not proportionately increasing IRS resources to meet those demands.

Three factors are essential to the IRS’s success in quickly identifying and solving systemic taxpayer problems –

- ◆ Executive and congressional commitment to adequately fund the IRS to accomplish the initiatives and goals it is required or expected to implement and achieve.
- ◆ The commitment of IRS senior management to acknowledge systemic problems, commit creative energy and attention to the solution of those problems, and integration of those solutions into the strategic plan.
- ◆ The continued oversight of the IRS by its various stakeholders, including Congress and the Oversight Board, with respect to immediate and long-term solutions of taxpayer problems.

The National Taxpayer Advocate’s Annual Report to Congress can serve as an organizing principle and the beginning of a dialogue about taxpayer problems. The Taxpayer Advocate Service believes that this year’s “Top 20” section sets a new standard in the exchange of information about these problems, and although we may not always agree with the IRS’s assessment of the proposed solutions, we commend the IRS for its tireless efforts in seeking answers and its open discussion of the problems. All of us – Congress, taxpayers, IRS and other federal employees – can learn a great deal about the complex problems facing the IRS and taxpayers in the discussion that follows.

**LONG TERM STRATEGY AND SOLUTIONS**

As this report goes to press, the IRS is commencing its 2005 Strategic Planning and Budget cycle. This process requires each IRS Operating Division and Function to identify strategies, operating priorities, and improvement initiatives for the forthcoming fiscal year



# PROBLEMS

as well as adjust the current year’s strategic plan. Early on in the cycle, all Functions and Operating Divisions comment on one another’s strategies through informal consultations and in a series of day-long meetings.

For this year’s strategic planning cycle, the Acting Commissioner has asked each Operating Division and Function to consider the problems identified by the National Taxpayer Advocate in her 2002 Annual Report. Each Operating Division and Function must address these problems in some manner in its strategic plan. Further, the IRS oversight board is committed to evaluating the IRS’s progress toward problem resolution.<sup>3</sup>

## CONCLUSION

The National Taxpayer Advocate believes systemic taxpayer problems will always be with us – it is in the nature of complex systems. However, she also believes it is possible to systematically identify and resolve those problems, quickly, as they arise. Even where the problem is difficult and requires a multi-year solution, immediate identification and planning is critical.

<sup>3</sup> IRS Oversight Board, “Oversight of the Office of the Taxpayer Advocate: Principal Findings and Actions,” September 2002, page 13.

### METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

Our analysts began researching these issues in the spring of 2002. We originally selected almost 30 issues for examination. While several of them are not presented here, the National Taxpayer Advocate intends to pursue them as potential advocacy projects and for inclusion in next year's report.

To arrive at the final list of problems and to determine the order of issues within the list, we objectively evaluated and ranked each taxpayer problem according to the following factors:

- ◆ Impact on taxpayer rights
- ◆ Percentage of taxpayers affected
- ◆ Barriers to taxpayer compliance, including expense, time, and burden
- ◆ Impact of noncompliance on tax revenue
- ◆ Congressional interest
- ◆ National Taxpayer Advocate interest
- ◆ External stakeholders interest
- ◆ Frequency of issue in TAS case advocacy database

The list reflects both positive and negative effects of the IRS reorganization that began five years ago. Some of the problems described in the National Taxpayer Advocate's 2001 report, such as delays in processing claims for joint and several liability relief, have lessened to the point where they no longer appear on the list. The IRS has also made progress toward reducing the burden taxpayers face in obtaining Employer Identification Numbers (EINs). However, this issue still appears on our list because of its impact on the many taxpayers who each year start new businesses or must handle the estates of deceased relatives and associates. Other issues, such as the growing volume of Collection Due Process (CDP) cases, appear on the list for the first time.

We were attempting to show that we balance our concern between the problems affecting individuals and businesses. Most of these issues affect both types of taxpayer; some apply to individuals exclusively while others impact only business.

### TAMIS LIST

We have also prepared a second list of taxpayer problems based solely on TAS case inventories as reflected by the Taxpayer Advocate Management Information System (TAMIS). This list, which appears as Appendix B, details the 25 issues that generated the most con-



tacts with TAS from October 1, 2001 through September 30, 2002. While some of the same topics appear on both lists of taxpayer concerns, the tracking codes used in TAMIS can encompass a variety of issues and may not reveal the underlying causes of problems. Further, taxpayers who contact TAS are a small subset of taxpayers who encounter problems with the IRS. For these reasons, we consider the Most Serious Problems list to be the most comprehensive account of the difficulties facing taxpayers (and IRS employees) in fiscal year 2002.

**IRS RESPONSE**

The Taxpayer Advocate Service shared its definition and analysis of each problem with the IRS Operating Division Commissioners to give them a chance to comment on the issues.<sup>4</sup> Their responses are published in full under the headings “IRS Comments” and “IRS Initiatives to Address the Problem.” We have also listed the “IRS Responsible Official” for each problem, although we recognize that other officials or Operating Division Commissioners may be involved in these issues. The National Taxpayer Advocate then comments on the IRS response.

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<sup>4</sup> IRC §7803(c)(2)(B)(ii)(IV).



**PROBLEM**

**TOPIC #1**

**NAVIGATING THE IRS**

**IRS RESPONSIBLE OFFICIALS**

- David R. Williams – Chief, Communications & Liaison Function
- John Dalrymple – Commissioner, Wage and Investment Division
- Joe Kehoe – Commissioner, Small Business and Self-Employed Division
- Larry Langdon – Commissioner, Large and Mid-Size Business Division
- Evelyn Petschek – Commissioner, Tax-Exempt and Government Entities Division
- David Robison – Chief, Appeals
- John Reece – Deputy Commissioner/Chief Information Officer for Modernization, Information Technology and Security Services
- David B. Palmer – Chief, Criminal Investigation

**DEFINITION OF PROBLEM**

Taxpayers and practitioners often cannot locate the person at the IRS who has the responsibility and authority for resolving a particular tax problem. Even IRS employees have difficulty determining who is accountable for program areas within the reorganized IRS.

**ANALYSIS OF PROBLEM**

The IRS mission of providing taxpayers with top quality service is impaired by the difficulty of identifying the particular employee who can resolve the taxpayer’s problem. One consequence of this is that taxpayers and practitioners seek assistance from the Taxpayer Advocate Service (TAS) on matters that normally would not require TAS intervention.

For example, if a taxpayer disagrees with a revenue agent, the taxpayer may have trouble reaching the agent’s supervisor because that person is in another state. If a problem involves two IRS functions such as Examination (auditing) and Collection, the taxpayer’s case may be passed back and forth because it is not clear who has authority to decide the issue. Local IRS representatives, who replaced District Directors, often do not have the same powers formerly vested in District Directors.

IRS employees are also frustrated by the lack of a clear understanding of the chain of command in the reorganized agency and by the difficulty of locating the person with authority to act. There is no published chart describing the IRS chain of command. Nor is there an internal or public directory with names, addresses, telephone numbers, and job descriptions that clearly indicate which employee deals with each program and how to reach that person.

MOST SERIOUS PROBLEMS



The IRS planned to provide point of contact information in one location via an Interactive Organizational Directory (IOD) on the internet, but this directory is not yet online, even though work began many months ago. The IRS is currently working on “The IRS Directory for Practitioners” in lieu of the IOD. The IRS is trying to improve the search capabilities of this directory before its online debut, which was initially scheduled for early October 2002 but is now planned for 2003.

An IRS web page entitled “Information for Our Partners” provided names, titles, telephone numbers and addresses, primarily for those in IRS leadership positions. However, the site was not well advertised and was missing key information. The Wage and Investment Division contacts were available at one time but then eliminated; the site did not permit a choice between Examination and Collection; nor did it offer appropriate details for those officials it listed, such as “assistance with offers-in-compromise,” or “office can establish an installment agreement,” or “office works EITC cases.” Currently, the entire web page has been temporarily withdrawn from the site.

The IRS public web site contains another option entitled “Around the Nation” with information on how to contact the IRS state by state and IRS toll-free phone numbers. However, callers must navigate a complicated menu system to reach live assistors – and when they finally connect to “real people,” taxpayers and practitioners report they are transferred from one employee to another and must explain their problems several times. Practitioners find that contacts established over the years have changed or vanished in the reorganized agency. Callers often need numbers for specific problems; for questions about an Offer-in-Compromise (OIC), a taxpayer may wish to contact an OIC manager, the local lien desk, or the bankruptcy hotline.

IRS employees too are frequently confused about who is responsible for providing assistance. Information about program responsibility is available internally through intranet sites; however, they lack uniform design or navigation protocols, are not widely publicized, and in some cases contain outdated information. Another problem is the lack of uniform nomenclature in referring to IRS organizational units. For example, Wage and Investment (W&I) Remote Examination, or auditing, has a counterpart in the Small Business/Self Employed (SB/SE) division called Service Center Examination, which may be collectively referred to as “Examination,” “Service Center Examination,” “Correspondence Examination,” or even “Corr Exam” within the IRS.

### IRS COMMENTS

We have made substantial progress in building a network of tools and services that will simplify the process of navigating the modernized IRS for taxpayers, practitioners and employees. However, we must recognize that this is a long-term and continuing effort. The IRS organization remained substantially unchanged for many years prior to the legislated reorganization of RRA 98 and practitioners and employees were quite familiar with how to navigate through the system. It is certainly understandable that a restructure on the massive scale experienced in the IRS would cause some confusion and require a significant period of adjustment. A natural resistance to change and the shift to customer-based rather than geographical organizations also complicated communication challenges. In addition, even without the reorganization, there have been changes, in both the public and private sectors, in preferred methods of interaction and information sharing with customers, requiring adjustments to familiar practices by both our customers and employees.

### IRS INITIATIVES TO RESOLVE PROBLEM

#### Taxpayers

For most taxpayers, the primary method of communicating with and getting information from the IRS is the telephone. To make this easier, the IRS has numerous general and specific toll-free lines to get tax help and resolve accounts, including lines for people with special needs, such as Spanish language or hearing impaired services. We also have new local numbers for over 400 Tax Assistance Centers, primarily aimed at making appointments in these offices. These are being published in local directories and are also on the IRS.gov web site. We realize that as we try to provide more diversified services, there can be confusion about what number to call.

In January 2003, IRS is implementing a significant improvement in its toll-free system that will assist taxpayers who might be confused about which number to call. In addition to segmenting our services by customer type and need, we will now be able to automatically transfer taxpayers' calls to the appropriate numbers that are dedicated to their particular service needs. Prior to this, for some specialized numbers, our assistants could provide the number, but the taxpayer had to make a separate call.

Increasingly, taxpayers are also using the Internet to communicate with and get information from the IRS. The newly reconfigured IRS.gov (<http://www.irs.gov/>) makes this process much easier by reflecting taxpayer segments and highlighting frequently used services. There is a key word search on the main page that can quickly take a taxpayer to the



requested subject. Finding out the status of a refund – probably one of the most frequently asked questions – is highlighted on the front page. An additional prominent feature is the ability to search for forms and publications – another one of the most frequently used services during tax season. Additionally, a taxpayer can find the phone number and address of a local office by accessing “Help”. This feature also offers the ability to submit e-mail questions and comments, get the phone number for the Help Desk or interact in real time with the help desk on the Chat Line.

### **Tax Professionals**

Feedback through our National Public Liaison office, the main office that works with tax professionals on a daily basis, indicates that tax professionals are well aware of “IRS.gov” and the services offered to them there. IRS.gov features an easily identifiable direct link for tax professionals on its first page. In addition to information on subjects such as the latest news, local filing locations and changes in legislation or procedures, the Tax Professionals’ page clearly highlights “Practitioner Priority Service.” This is a new toll-free, accounts-related service for all tax practitioners nationwide at 1-866-860-4259 that serves as the practitioners’ first point of contact for assistance regarding taxpayers’ account-related issues. This replaces the former Practitioner Hotline. There is also a page that aligns the states to practitioner priority service sites so that tax professionals can locate the office that deals with their issues.

The IRS Directory For Practitioners (IDFP), planned for implementation in 2003, is a web-based, interactive directory for practitioners allowing them to search for point of contact information. Searches can be performed using keywords, contact demographics, or operating division or functional unit. This was tested with three practitioner groups in September 2002 to positive response.

For those taxpayers and practitioners who are dealing directly with a field agent or other IRS employee working a case, there should be little difficulty in contacting a supervisor or securing information about procedures, taxpayer rights, etc. from that employee. We believe that the new organization has matured enough so that difficulties are the exception rather than the rule.

### **Employees**

We recognize that one of the most important keys to navigating the new IRS lies with employees. When employees are knowledgeable about the organization, they are better able to assist taxpayers and practitioners who have questions. A number of tools have been or are being developed to assist employees, including the Corporate Authoritative Directory Service, (CADS) and the Discovery Directory.

The CADS system currently collects data in three categories: People, Business Units, and Location information. Eventually the categories will expand to encompass all of our resources. The Discovery Directory allows any employee with access to the IRS intranet to find information on people, business units and geographic location. However, the currency of information in the Directory is a recognized problem since employees are responsible for making sure their information is up to date. The IRS will reinforce that responsibility to all employees.

An additional tool, the Program Responsibility Matrix, gives the employee the ability to find the part of the IRS that has the responsibility for a specific program area, providing a phone number for primary contact, links to other involved functions and the relevant Internal Revenue Manual (IRM) sections. The Program Responsibility Matrix is located on the IRS Intranet and is two clicks from the Home Page. We agree that this information needs to be updated and maintained more rigorously. The IRS Office of Servicewide Policy, Directives and Electronic Research will be responsible for this task, which we hope to have accomplished by the end of the second quarter 2003.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*We applaud the IRS for its efforts at building a network of tools for taxpayers, tax practitioners and IRS employees to make the agency's organization more understandable and to increase access to it and within it. The size and complexity of the IRS, together with the changes brought about by the recent reorganization, make the task especially challenging. Despite these efforts, however, taxpayers and the tax practitioner community remain frustrated when communicating with the reorganized IRS. The IRS modernization realigned many program responsibilities. A single, all-encompassing tool is needed to identify the business unit and office primarily responsible for each IRS operational and support program. This tool must contain easily identifiable information to allow customers to make the right contact to resolve their tax problems.*

*The Taxpayer Advocate Service is pleased that taxpayers and tax professionals can use the IRS toll-free telephone service and the IRS web site to determine the status of a refund, to request tax forms and publications, and to obtain IRS toll-free telephone assistance. With the newly reconfigured "IRS.gov" many tax professionals appear to be well informed about the services available on the IRS web site. However, TAS continues to be concerned about accessibility when more in-depth assistance is needed to resolve a problem. The IRS' very successful "Problem Solving Days" showed the benefits of accessibility to IRS managers and technical assistance for solving taxpayer problems.*

*The IRS began work on an Interactive Organizational Directory (IOD) more than a year ago, but it has not been delivered. Putting the IOD online was hindered by the inability to keep the directory*



updated as employees changed jobs in the evolving IRS. Alternatively, the IRS worked to replace the concept of an organizational directory with an IRS Directory for Practitioners (IDFP). This was designed to automatically update IRS employee information from the “Discovery Directory,” an internal source for locating IRS employees. TAS was involved in these efforts and reported that while the IDFP had potential when users knew who they were looking for, the IDFP keyword search feature was lacking.

In October 2002, the directory was promoted and available online for a few days, and then was removed from the IRS web site. During the short time this directory was accessible, it was difficult to find on the web site. The IRS plans to re-introduce the IDFP in 2003, but TAS is concerned about further delays in putting it into effect. A specific date for implementation is imperative. Furthermore, we believe that taxpayers and IRS employees should have access to that (or a similar) site.

The IRS has referenced a number of tools for identifying the employee or part of the organization that can solve particular problems. Although TAS appreciates the ongoing efforts of the IRS to improve the functionality and visibility of these products, these tools provide taxpayers with only limited ability to gain greater access to IRS officials who can solve problems. Our specific comments on the IRS initiatives are as follows:

- ◆ Publishing telephone numbers for Taxpayer Assistance Centers (TACs) on the web and in telephone directories is not very helpful when a customer wants to speak to a person, because the calls go to an answering machine rather than to “live” assistance. Furthermore, TAC assistance will be scaled back in filing season 2003.
- ◆ The telephone number on the web for customers calling from Canada is listed as Puerto Rico when a Philadelphia Service Center number is given. Canadian customers may be reluctant to contact this number because they anticipate prohibitive long distance charges to Puerto Rico.
- ◆ The keyword search features of the internal and external web sites can be helpful, but often require the user to wade through a large number of search results. The results are sometimes irrelevant; for example, a search for installment agreements resulted in primary references for installment sales. Taxpayer-friendly naming conventions should be resident throughout any directory.
- ◆ The “Help” and “Chat Line” features address technical problems in use of the web site rather than account or tax law questions.

- ◆ *As of the date this report went to press, the IRS web page entitled “Information for Our Partners,” which provided names, titles, telephone numbers, addresses and broad job descriptions for IRS leadership positions, has been removed from the web site. This web page was not well advertised and was lacking in specificity regarding program responsibility for the listed officials. However, it was a source that customers could use to determine initial points of contact in the IRS. This ability has been lost by its removal from the web.*
- ◆ *IRS employees can obtain information about program responsibility from business unit web sites, but complain that the sites are difficult to navigate because they lack uniform protocol and nomenclature. Some employees are unaware of these directories and how to use them because of training limitation and time constraints. Employees need a uniformly designed directory, accessible from one location.*
- ◆ *The IRS highlights the Discovery Directory and the Program Responsibility Matrix as tools that map out the new IRS. The Discovery Directory provides names, phone numbers, business units and geographic locations, but lacks information about program responsibility, while the Matrix helps with program responsibility but does not provide names of the responsible officials. A blend of these two tools to provide one enhanced tool is needed.*

*Taxpayers, practitioners and IRS employees need to know the IRS chain of command. An easy-to-access, user-friendly list is needed, one that clearly displays who reports to whom and includes names, addresses, and telephone numbers, as well as IRS roles and responsibilities. The IRS should ensure that directory information is continually updated as needed. Uninformative, broad categories such as “leadership” or “compliance” offered in the “Information for Our Partners” on the IRS web site should be avoided. To help guide customers to determine where to go on first contact, specific IRS processes should be clearly identified. For example:*

**TABLE 1.1.1  
IRS PROCESSES**

Power of Attorney	Employer Identification Numbers
Return Photocopies	Audit Reconsiderations
Records of Account	Amended Returns
Address Changes	Estate & Gift Tax
Innocent Spouse Claims	Employment Taxes
Highway Use Tax	Estimated Taxes
Appeals	Federal Tax Deposits
Tracing Payments	Underreported Income



*In addition to a customer directory, a list of contacts for local issues is needed. This list could be accessed by state and should include local phone numbers for the lien desk, the bankruptcy liaison, the practitioners' complaint line, the coordinator for return preparers, and the state's income tax customer service line. Fax numbers for Offer-in-Compromise (OIC), Employer Identification Number (EIN), and Centralized Authorization File (CAF) should also be part of this local list.*

*Clearly, the IRS must continue to give priority attention to a customer directory for taxpayers, practitioners and IRS employees. The IRS modernization began nearly four years ago. The efforts to provide a directory have fallen short of goals. Communicating the changes in organizational structure to taxpayers as well as to IRS employees is an important aspect of this effort. The reorganization is undermined by not getting this information out to the public. Practitioners and taxpayers often seek out the Local Taxpayer Advocate when they do not know where to go, consuming the limited resources of TAS on matters that normally should not require TAS' intervention.*

*Accessibility and transparency are critical elements for a representative government and enhance confidence in the tax administration system. The IRS is clearly attempting to meet these goals, but a sustained effort, and commitment from senior leadership down to the front-line employees, is necessary. Customer service requires that taxpayers be able to navigate the system and locate the appropriate people for assistance.*



## PROBLEM

### TOPIC #2

## PROCESSING OF OFFER-IN-COMPROMISE (OIC) CASES

### IRS RESPONSIBLE OFFICIAL

Joe Kehoe – Commissioner, Small Business/Self-Employed (SB/SE) Division

### DEFINITION OF PROBLEM

Policy Statement P-5-100 provides, in part, that offers-in-compromise are discussed as a collection alternative, receive prompt and fair decisions, that they are negotiated, that they are an acceptable alternative to a protracted installment agreement or reporting that the liability is currently not collectible, and that they promote future compliance.<sup>5</sup> The current offer process, while having made progress toward achieving these goals over the past year, has yet to fully realize the terms of the policy statement.

### ANALYSIS OF PROBLEM

#### History

Since the adoption of Policy Statement P-5-100 in 1992, the IRS has struggled with the design and administration of the offer-in-compromise program. Such a program must balance the efficient processing of over 113,700<sup>6</sup> offers received per year with the need to carefully review each offer in accordance with the terms of the policy statement.

Prior to August 2001, all offers regardless of their level of complexity were handled in the field by revenue officers, generally known as offer specialists. In that month, the IRS commenced a new approach to processing offers, the Centralized OIC (COIC) initiative. The initial processing of all offers, and complete processing of wage earner offers, is now handled in two campus locations. The number of revenue officers investigating offers in the field has been reduced from over 1,000 in April 2001 to approximately 500 in October 2002.<sup>7</sup> While SB/SE implements measures to improve the timeliness of decisions as required by the policy statement, it must also ensure that all taxpayers have the

<sup>5</sup> Policy Statement P-5-100 provides:

The Service will accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. An offer in compromise is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Government. In cases where an offer in compromise appears to be a viable solution to a tax delinquency, the Service employee assigned the case will discuss the compromise alternative with the taxpayer and, when necessary, assist in preparing the required forms. The taxpayer will be responsible for initiating the first specific proposal for compromise. The success of the compromise program will be assured only if taxpayers make adequate compromise proposals consistent with their ability to pay and the Service makes prompt and reasonable decisions. Taxpayers are expected to provide reasonable documentation to verify their ability to pay. The ultimate goal is a compromise that is in the best interest of both the taxpayer and the Service. Acceptance of an adequate offer will also result in creating for the taxpayer an expectation of and a fresh start toward compliance with all future filing and payment requirements.

<sup>6</sup> SB/SE, *IRS Commissioner Update on Offer-in-Compromise*, September 25, 2002.

<sup>7</sup> *Id.*



opportunity to negotiate their offers fairly and that those offers remaining in the field receive prompt consideration.

#### Discussion of the Offer as an Alternative

The volume of offer receipts indicates that taxpayers are being apprised, either by SB/SE or practitioners, of the OIC alternative. However, high return and rejection rates also indicate that taxpayers and practitioners may not understand when offers are an appropriate alternative. Though SB/SE has committed to significant revision of the Form 656, Offer-in-Compromise, and its instructions in FY 2003, additional outreach is necessary to gauge customer expectations and to garner specific feedback on customer satisfaction as required by IRS' balanced measures approach.

#### Prompt Offer Determinations

As of September 10, 2002, the Automated OIC (AOIC) database indicates that 65.1 percent of field inventory remains over its target timeframe of six months.<sup>8</sup> SB/SE needs to continue to monitor field inventory and receipts before making any further reductions in field staffing. As the COIC initiative promised more efficient processing, SB/SE needs to establish and communicate shorter timeframes for those cases totally processed within COIC, as well as establish an easy way for taxpayers and practitioners to stay apprised of the status of their case.

#### Fair Offer Determinations

SB/SE uses its Collection Quality Measurement System (CQMS) to measure its employees' compliance with Internal Revenue Manual (IRM) requirements. According to the October 2002 closed case review reports, cumulative quality scores for "financial analysis" were at 67.2 percent, "ability to pay" at 60.2 percent, and "correct determination of the offer amount" at 60.2 percent.<sup>9</sup> As a result, significant numbers of taxpayers may have their cases returned or rejected in error. SB/SE needs to conduct further analysis to tie its quality results to business measures, and must set objectives for reducing rejections and returns of offer cases. In addition, operating procedures now in the form of "Desk Guides" at the COIC sites should be made part of the IRM so that those procedures are subject to the CQMS review.

#### Negotiating the Offer

Taxpayers and practitioners frequently complain to TAS that their offers are rejected when a single telephone call from IRS would have resolved any questions. The IRS uses a "combination" letter that simultaneously rejects the taxpayer's offer, and gives the taxpayer 30 days to either provide additional information to support the offer, or to request an

<sup>8</sup> AOIC Database Reports, *Inventory Listing for Areas 1-18*, September 10, 2002.

<sup>9</sup> SB/SE, Collection Quality Measurement System Report, September 30, 2002.

administrative appeal. In some instances, it appears that these letters are received by the taxpayer well into the 30-day period, and that requests for additional time are not routinely granted. This combination letter saves processing time and postage costs over the practice of sending an interim analysis/request for information followed by a final determination and appeals notice letter. However, the latter procedure gives meaning to the policy statement's concept of a negotiated offer. Taxpayers often need the opportunity to explain their case, including special circumstances and variances from the national standard expenses, before their case is rejected. SB/SE's failure to recognize and address special circumstances was previously cited in a May 2001 TIGTA report.<sup>10</sup> Failure to negotiate the offer in SB/SE does not resolve the collection case, causes re-work, and increases burden on the taxpayer and Appeals. SB/SE must continually review the cases being received in Appeals to determine if, by better communication, they might have been resolved in Operations.

#### **Offers as an Acceptable Alternative**

The policy statement says that an offer-in-compromise is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement. However, SB/SE has not collected data on the collection outcome of cases in which offers are rejected, and routinely secures waivers to extend collection statutes beyond 10 years to accommodate installment agreements. Without such specific data, SB/SE's compliance with offer policy as it relates to collection alternatives cannot be measured.

#### **Future Compliance**

An often overlooked by-product of an offer is providing a fresh start toward compliance. The IRS requires the taxpayer to agree to remain in compliance with tax obligations for the five years immediately following acceptance of the offer. Failure to satisfy this compliance commitment may result in default of the offer and a reinstatement of the tax liability. As part of SB/SE's automation of post-acceptance processing, we recommend tracking the taxpayer's ongoing compliance over a five-year period in order to measure the effectiveness of this objective.

### **CURRENT IMPROVEMENT INITIATIVES**

#### **Overview**

SB/SE placed an executive in functional command of the OIC Program, reporting directly to the Deputy Commissioner, SB/SE. The executive has sought input from internal stakeholders, including TAS and Appeals, on proposed procedural issues. Specifically, TAS has provided significant input on revisions to Form 656, user fee implementation,

<sup>10</sup> Treasury Inspector General for Tax Administration, *The IRS Needs to Consistently Use Special Circumstances in the OIC Program*, TIGTA-2001-30-096, May 31, 2001.



Effective Tax Administration (ETA) offers, taxpayer correspondence, batch processing, the type of cases to be worked in COIC, extensions due to hardship, documentation requirements and messages to external stakeholders. We anticipate that an executive will remain in charge until specific OIC business objectives are realized.

### Form 656

A team is working on a complete revision of the Form 656 to clearly state IRS Offer policy and to simplify instructions, particularly on the conditions for acceptance, on the worksheet for computing the offer amount, and on financing the offer. Additionally, there will be an opportunity for the taxpayer to certify prerequisite compliance and/or lack of requirement to file. Success of this initiative can be measured by a reduction in the percentage of offers returned to taxpayers.

### Effective Tax Administration (ETA) Offers

Form 656 will be revised to clearly identify offers submitted on the basis of Effective Tax Administration (ETA).<sup>11</sup> However, many taxpayers and representatives believe that the IRS will only consider equity and public policy issues under the ETA regulations, which apply to taxpayers who can fully pay the tax liability. Form 656 should be revised to instruct those taxpayers who cannot afford to fully pay the liability to identify any special circumstances that would qualify them for acceptance of an offer under doubt as to collectibility for less than the reasonable collection potential.

### User Fee

SB/SE is continuing to work closely with internal stakeholders on the implementation of a user fee within the next year. This fee will help to offset the costs associated with offer processing and discourage inappropriate offers. Under the proposed fee, some low income taxpayers are exempt as are taxpayers submitting offers under doubt as to liability.<sup>12</sup> The fee for taxpayers whose offers are accepted under ETA provisions will be refunded. The new fee, if adopted, will be explained in an addendum to Form 656. Public hearings are scheduled in early February 2003.

<sup>11</sup> The Conference Report to RRA 98 states that “the conferees expect that the present regulations will be expanded so as to permit the IRS, in certain circumstances, to consider additional factors (i.e., factors other than doubt as to liability or collectibility) in determining whether to compromise the income tax liabilities of individual taxpayers. For example, the conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer’s income tax liability would promote effective tax administration.” H.R. Conf. Rep. No. 105-999, 1998. A final Treasury Regulation published on July 18, 2002 clarified the bases for ETA offers. T.D. 9007.

<sup>12</sup> The National Taxpayer Advocate had advocated that taxpayers whose income is at or below 250 percent of the federal poverty guidelines be exempt from the user fee, which is the eligibility cap for persons receiving assistance from Low Income Taxpayer Clinics under IRC § 7526. The proposed regulations exempt taxpayers with incomes at 100 percent of the federal poverty guidelines. Prop. Treas. Reg. §300.3(6)(1)(ii).

### Post-Processing of Accepted Offers

TAS has received customer complaints concerning SB/SE's post-processing of accepted offers. Sometimes taxpayers fail to understand that the IRS will keep any refund they are due in the year that the offer is accepted. This needs to be more clearly explained in the Form 656 instructions. Other complaints concern establishing separate accounts where joint liabilities are involved, including the adjusting of accounts and posting payments. SB/SE has committed to enhance automation to improve post-processing and monitoring of compliance and collateral agreements. Target dates for implementing these improvements need to be established.

### Documentation Requirements

In an attempt to reduce taxpayer burden, certain taxpayer documentation requirements have been eliminated where the IRS can obtain the information from internal sources. SB/SE has committed to conduct ongoing analysis of the documentation requirements and require substantiation only for those items that have a significant probability of affecting the outcome.

### IRS COMMENTS

Fiscal year 2002 was a year of significant accomplishment for the Offer in Compromise (OIC) Program. The centralized OIC (COIC) operations at the Memphis and Brookhaven campuses became fully operational. Staffed by 342 process examiners and 237 offer examiners, these sites now receive almost all new offers for initial processing. Only the most complex new cases are sent to the field for investigation. Meanwhile, during much of FY 2002, revenue officer staffing was maintained in the two sites to focus on the backlogged cases. By the end of the year, the OIC inventory had been reduced by more than 20,000 cases, or 21 percent.

As part of the effort to focus more attention on the needs of the OIC Program, in April 2002, IRS assigned an executive to lead the OIC Team. Under this new leadership, we implemented a number of process changes in the centralized sites to realize greater efficiency from economies of scale:

- ◆ Implemented a screening process to identify taxpayers who have the financial ability to "full pay" early in the OIC process. (In approximately 14 percent of all submissions the taxpayers are inappropriately requesting compromise because, by their own financial statements with no verification, they can clearly pay in full.)
- ◆ Identified and transferred complex cases to the field earlier in the process.
- ◆ Determined which OIC cases should be handled in the field offices based on the taxpayer's current sources of income, rather than on the amount of the liability.



- ◆ Reduced the amount of information required for the typical investigation. For example, wage earners need only provide pay statements, bank statements, and verification of insurance cash value, retirement accounts, investments, and loan balances.
- ◆ Determined reasonable collection potential by using the taxpayer's submitted information and available electronic verification techniques. This practice reduces the need for additional requests for information and for negotiation. Offers may now be "rejected with options" when the offer is clearly insufficient.

The temporary regulations published in 1999 were made permanent in 2002 with minor modifications. Under these regulations, an independent administrative review is required of all offers before a decision to reject is communicated to the taxpayer. The regulations also clarify that the Effective Tax Administration (ETA) standard for economic hardship applies only to individual taxpayers and not to other (business) entities. In addition, under ETA the standard for public policy and equity (non-hardship) places the responsibility on the taxpayer to demonstrate why his or her special circumstances justify a compromise, even though a similarly situated taxpayer must pay the full liability. Finally, for cases in which the unpaid tax liability is directly attributable to the acts of others, and was incurred although the taxpayer made every effort to comply, compromise is authorized.

#### **IRS INITIATIVES TO RESOLVE PROBLEM**

##### **Discussion of the Offer as an Alternative**

As one component of our communication and education strategy, we are revising the Form 656 to clearly state IRS Offer policy and to simplify instructions, particularly on the conditions for acceptance, on the worksheet for computing the offer amount, and on financing the offer. The Office of Performance, Research and Analysis (OPERA) has been directed to study the specific attributes of not processable offers so as to improve communication initiatives and identify other improvement possibilities.

We maintain a high level of engagement with the major practitioner groups. Recently, we held a one-day session with the IRS Advisory Committee (IRSAC) at the COIC site in Brookhaven. This session included a tour of the facility, a detailed explanation of the process, interaction with front-line employees, and detailed discussions involving analysis of rejected/returned cases. We are developing web-based applications to assist practitioners in the analysis of potential offer candidates. We are working with our Toll Free and Automated Collection System operations to ensure a clear understanding of how an offer-in-compromise fits into the overall collection strategy. We even are exploring the feasibility of a stand-alone Offer toll free number staffed by specially trained employees.

As noted by the National Taxpayer Advocate, IRS is taking steps to implement a new user fee next year. This fee will help to offset the costs associated with offer processing and discourage

inappropriate offers. Under the proposed fee, some low income taxpayers are exempt, as are taxpayers submitting offers under doubt as to liability. The new fee will be explained in an addendum to Form 656. Public hearings are scheduled in early February 2003.

#### **Prompt Offer Determinations**

In the COIC operation, we have standardized and reduced the amount of financial verification required from a taxpayer. If a wage earner submits all the required documentation (which is described clearly on the Form 433), he or she receives a prompt decision based on the merits of their case. If the taxpayer does not provide the required documentation, a detailed letter is issued describing exactly what is needed to make a determination. The letter includes a toll free number the taxpayer may call to get additional information. As mentioned earlier, a “full pay” screening process has been instituted, which utilizes the taxpayer’s unqualified financial information submission early in the process. The approach helps us to reduce taxpayer burden through early identification and resolution of cases that do not qualify for the OIC option.

During FY 2002 we experienced dramatic gains in the currency of the field inventory. The older cases are being worked on a first-in/first-out basis, which has reduced the percentage of field inventory aged beyond six months from 80 percent in March 2002, to 57 percent at the end of the fiscal year. The field offer inventory has continued to decline in the early weeks of FY 2003, even as we reassign revenue officers from OIC to traditional duties in the field. We are currently forming a team to transfer best practices learned in COIC to field operations.

#### **Fair Offer Determinations**

We are developing balanced measures for the offer program, including quality and timeliness. Although the current Collection Quality Measurement System (CQMS) reviews do sample COIC cases, the review criteria we are using were developed for field cases. Consequently, we are developing unique COIC quality review standards and reports, as well as updating the traditional CQMS standards used in field reviews. In the interim, the COIC sites are conducting ad hoc quality reviews of the offer inventory. We concur with the need to update the IRM and are in the process of doing that.

We are not satisfied with the level of accuracy for our screening process. More analysis of the quality results is needed to interpret these findings. It should be noted that a failure to meet this quality standard can not only mean that the taxpayer’s case OIC request was returned or rejected in error, but in some cases indicates that an OIC request was accepted in error.



We disagree that we should set objectives for reducing rejections and returns of cases at this point. Each case should be closed based on its individual merits, and setting outcome-based targets could result in inappropriate case decisions. The OPERA study will be critical to determine why OIC cases are returned or rejected. We expect the outcome of that study will help us to formulate program changes to improve customer service and the overall OIC process.

### Negotiating the Offer

An offer is returned or rejected when a taxpayer does not provide the minimal amount of financial documentation after two requests (once on the initial submission, and again in a follow-up letter). In these rejection cases, we provide the taxpayer with a letter communicating several options. These include calling the offer examiner or revenue officer to try reaching a resolution, providing additional documentation that could impact the financial analysis, or requesting that the case go to Appeals. The taxpayer can choose one or more of these options. All rejections are subject to an independent administrative review. All “special circumstance” offers are also subjected to secondary management reviews, and in addition we are working with the Taxpayer Advocate’s office to develop a secondary review process for all non-hardship ETA offers.

### TAXPAYER ADVOCATE SERVICE COMMENTS

*We appreciate the continuing efforts of SB/SE to improve OIC processing. The function is trying to resolve a backlog of offer cases that accumulated over an extended period of time. A permanent correction will take longer than a short term fix. Placing an executive with functional oversight over the program was certainly a step in the right direction. SB/SE must ensure that all of its efforts are directed toward fulfillment of the terms of Policy Statement P-5-100. Though SB/SE has competing resource objectives including a reduction of revenue officer staffing in the OIC program, it must take actions to ensure that taxpayers’ right to fair and prompt consideration are paramount.*

*SB/SE indicates it has reduced its total inventory by 21 percent over the last fiscal year and reduced aged field inventory from 80 to 57 percent over the last six months of the fiscal year. We urge SB/SE to be cautiously enthusiastic about its achievements and to balance that measure with commensurate increases in the quality of its work product. Quality results that indicate 40 percent of taxpayers may not have had a correct determination of their ability to pay, or a correct determination of their offer, color the achievement of increases in offer dispositions. These cases may also consume resources in other programs, since the taxpayer has not resolved his or her case.*

*Certainly, increased dispositions will increase the number of determinations being appealed. SB/SE must look closely at the final case determinations by Appeals as a further indicator of the quality of its achievements. Neither Appeals nor TAS wants taxpayers coming to them because they could not have*



*their issues addressed in SB/SE. We strongly urge the function to adopt measures to monitor this concern. SB/SE needs to ensure that the finding of the May 2001 TIGTA report mentioned earlier, citing its failure to recognize special taxpayer circumstances, is not a continuing problem. Additional managerial review of those cases where the special circumstances are denied is of no value if the special circumstances are not first identified and addressed. Though the IRS requires measurement of customer satisfaction, SB/SE continues to make operational decisions with only anecdotal knowledge of customer concerns with the OIC program. Specific measures of customer satisfaction for the OIC program must be implemented to clearly identify opportunities for improvement.*

*SB/SE has expressed concerns over our suggestion to set objectives for reducing rejections and returns. Although it may not be desirable to measure rejections if that would cause SB/SE's employees to make incorrect determinations, the same cannot be said for returns. Offers are **returned** to taxpayers **without appeal rights** when taxpayers do not comply with Form 656 instructions and/or fail to submit required information. Offers are **rejected with appeal rights** when, after analysis of the case, it is determined that the offer should not be accepted. SB/SE indicates it has found that 14 percent of offers are rejected in the screening process because the taxpayers' own figures do not support the offers. As SB/SE has begun work with OPERA to determine the attributes of returned offers, it is clear that a reduction of returned offers is a desirable and measurable objective. Although efforts are underway to improve the Form 656 instructions and worksheets and provide interactive web site assistance, we also encourage additional outreach that will further assist the taxpayer in preparing the required forms, as required by the policy statement.*

*SB/SE indicates that offers are returned after two requests for the information, a statement that is only true if the Form 656 is considered the first request. Taxpayers actually only receive one request to provide additional information after the offer has been filed. Cases received by TAS and practitioners indicate that such requests for the information were mailed late, and did not effectively allow the full 30 days to provide the additional information.*

*We note that SB/SE has not addressed the National Taxpayer Advocate's concern about the use of the confusing "combination" letter, which offers the taxpayer three options. Two of these options involve communicating with offer personnel about the specifics of the case and one involves the request for an administrative appeal. This letter truncates what used to be a two-step process – first, asking for additional information and later informing the taxpayer of a final rejection with notification of the right to appeal that determination. The National Taxpayer Advocate believes that combining these two steps sacrifices clear notification of a taxpayer's rights, eliminates an opportunity to submit additional documentation, and leads to re-work of cases by other functions.*

*SB/SE's manual processes for completing adjustments to accounts after the acceptance of an offer and for monitoring future compliance are cumbersome, labor-intensive and, as TAS receipts have shown, prone to error. We encourage SB/SE to set a target date for completing automation of post-processing*



to prevent problems with accounts and to facilitate monitoring of future income collateral agreements and compliance. In addition, efforts must be initiated to determine the eventual collection outcome of those offers that are rejected in order to determine if the reasonable collection potential (RCP) formula now in use is an accurate tool for determining whether an offer should be accepted.

### *Effective Tax Administration Offers*

The National Taxpayer Advocate believes that the recently issued final regulation on offers-in-compromise<sup>13</sup> contains more than “minor” changes, at least with respect to non-hardship Effective Tax Administration (ETA) offers. The regulations make clear, as does the legislative history, that ETA offers may be accepted on the basis of hardship, equity, and public policy. It is the latter two categories that the IRS has had difficulty administering.

The final regulation and its preamble make clear that an attempt to list eligibility factors for a non-hardship ETA offer would have the effect of limiting its application. It is desirable (for both taxpayer compliance **and** confidence reasons) that non-hardship offers be reviewed not only closely but also with an open mind. It is also true that the regulation places the burden on the taxpayer to demonstrate why he or she should be relieved of part of a tax liability that is both collectible and due, where all other taxpayers go about their business and pay their tax liabilities in full.<sup>14</sup>

The National Taxpayer Advocate and SB/SE agree that these non-hardship ETA offers will be unusual and limited in number. The final regulation clearly states that a taxpayer’s ETA offer will not be considered unless the taxpayer does not qualify for an offer on any other basis (collectibility or liability). However, when such an offer is filed, SB/SE must have in place a system to recognize it and process it appropriately.

The National Taxpayer Advocate is pleased that SB/SE has agreed to assign all non-hardship ETA offers to a small team of revenue officers who will, over time, identify common factors that can lead to additional guidance in this area. In recognition of the entire Service’s keen and diverse interests in this unusual and fact-specific relief provision, SB/SE has agreed to establish a cross-functional team, including representatives from TAS, Appeals, and Counsel as well as SB/SE, that will review all non-hardship ETA offers. This cross-functional approach will lead to non-hardship ETA offer determinations that balance compliance, fairness, hardship, equity, and public policy considerations.

We thank SB/SE for considering our input as they improve the offer program and we look forward to working with them to achieve a program that fulfills the IRS offer policy. The National Taxpayer Advocate views her and her office’s working relationship with OIC and COIC personnel as a model for systemic problem-solving within the IRS.

<sup>13</sup> Treas. Reg. § 301.7122-1.

<sup>14</sup> The National Taxpayer Advocate is aware that not all taxpayers pay their tax liabilities. The excuse that “other people do it” is not sufficient justification for a non-hardship ETA offer, nor should it dilute the foundational expectation that taxpayers comply with their tax obligations.

## PROBLEM

### TOPIC #3

### MATH ERROR AUTHORITY

#### IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/ Self-Employed Division

#### DEFINITION OF PROBLEM

The IRS issued approximately seven million math error notices in fiscal year 2001.<sup>15</sup> There are four major deficiencies in the current program:

- ◆ Taxpayers find the notices confusing, offering inadequate explanations about the items that the IRS modified or denied on their tax returns.
- ◆ Taxpayers have difficulty reconciling the adjustments with their originally filed tax returns.
- ◆ Taxpayers are not sure how to correct the notice of adjustment
- ◆ Taxpayers are not sure how to challenge the notices, nor do they understand their rights to challenge them.

#### ANALYSIS OF PROBLEM

Under math error authority, taxpayers are issued notices identifying the mathematical or clerical errors on their tax returns. The notice identifies the correct amount of tax, as opposed to what was reported on the original return, and indicates the additional tax assessed. If the taxpayer wants an abatement of the IRS adjustment, the request must be made within 60 days.<sup>16</sup> If the taxpayer provides information that justifies abatement, the abatement is completed and the taxpayer is informed. If the taxpayer responds, but the information is inadequate, the taxpayer is notified and the case referred to Examination (auditing) under deficiency procedures.<sup>17</sup>

The term “mathematical or clerical error” in IRS processing has taken on a new meaning in the past several decades. Originally, the term meant “errors limited to those inconsistencies where it can be determined from the face of the return which inconsistencies are correct.”<sup>18</sup> The math error procedure has expanded beyond its original usage. In 1976, two significant modifications occurred.<sup>19</sup> First, Congress ratified IRS practice by expanding the scope of the provisions of Internal Revenue Code section 6213(g) to include “clerical

<sup>15</sup> IRS Notice Volume Reports.

<sup>16</sup> IRC § 6213(b).

<sup>17</sup> Internal Revenue Manual 21.4.4.4 (Rev. 10/01/2001), Math Error Substantiated Protest Processing, and Internal Revenue Manual 21.5.4.4.5 (Rev. 10/01/2001), Math Error Unsubstantiated Protest Processing.

<sup>18</sup> General Counsel Memorandum G.C.M. 39131; 1984 IRS GCM LEXIS 18, page 4.

<sup>19</sup> Tax Reform Act of 1976, Pub. L. No. 94-455, Section 1206(a).



errors,” listing the types of errors in some detail.<sup>20</sup> Second, taxpayers were granted authority regarding abatement rights in a new Internal Revenue Code section 6213(b)(2).<sup>21</sup> Before this amendment, taxpayers had no statutory right to request abatement or receive judicial review before paying the tax. In practice, the IRS agreed to abate the assessment if taxpayers could explain timely and satisfactorily that there was in fact no error on their tax return.

Over the years, the IRS has encouraged the expansion of math error processing to encompass issues that in the past were treated under traditional audit deficiency procedures. Because of this expansion of authority, taxpayers lose the fundamental appeal rights and access to judicial review that are inherent in traditional IRS audit procedures.

The notice process is intimidating, especially for low income and underrepresented taxpayers. Consequently, these taxpayers frequently fail to respond, respond inadequately or do not have their alternatives clearly explained to them when they do respond. For example:

Taxpayer A calls the IRS 1-800 telephone number and advises the telephone assistant that he does not understand why the adjustment was made to his account. After the telephone assistant explains the adjustment, and Taxpayer A states “I don’t agree,” many times the assistant will inform the taxpayer they need to file a claim, and offer no further explanation.

The possible loss of access to administrative appeal and judicial review is of particular concern to the National Taxpayer Advocate. If a taxpayer timely requests an abatement of tax, the IRS is obligated to make the adjustment and make any reassessment through audit deficiency procedures.<sup>22</sup> Unless the taxpayer proactively requests abatement and is

<sup>20</sup> IRC § 6213(g) (2) The current definitions of “mathematical or clerical error” include various issues such as:

- A simple math error,
- Use of the wrong tax table or line from tax table,
- Errors entering information from schedules to the tax return,
- Omission of required entries on the return,
- Entries that exceed the statutory limit,
- Claim for credit related to self-employment tax where the tax on net earnings has not been paid,
- Omission of correct taxpayer identification number(s) as statutorily required, and
- Inclusion of an incorrect taxpayer identification number(s) where statutorily required.

<sup>21</sup> IRC § 6213(b) Exceptions to restrictions on assessment. (2) Abatement of assessment of mathematical or clerical errors.

(A) Request for abatement. Notwithstanding section 6404(b), a taxpayer may file with the Secretary within 60 days after notice is sent under paragraph (1) a request for an abatement of any assessment specified in such notice, and upon receipt of such request, the Secretary shall abate the assessment. Any reassessment of the tax with respect to which an abatement is made under this subparagraph shall be subject to the deficiency procedures prescribed by this subchapter.

(B) Stay of collection. In the case of any assessment referred to in paragraph (1), notwithstanding paragraph (1), no levy or proceeding in court for the collection of such assessment shall be made, begun, or prosecuted during the period in which such assessment may be abated under this paragraph.

<sup>22</sup> IRC § 6213(b).

granted entry into audit deficiency procedures, the right to petition the United States Tax Court in a deficiency proceeding (the only pre-payment tax judicial forum) is lost.<sup>23</sup>

The IRS has made progress in redesigning math error notices, yet many taxpayers remain confused about explanations of adjustments, which are difficult to follow within the notices and do not correlate to specific line numbers on returns. The following is a current explanation on a math error notice:

“We lowered your tax because you subtracted your deductions from your adjusted gross income incorrectly.”

*A better explanation would be: “We lowered your tax because you subtracted your total itemized deductions ‘line 36, Form 1040,’ from your adjusted gross income ‘line 34, Form 1040’ incorrectly.”*

Under current guidelines, the process of revising notices can take 17 months, but it often takes longer.<sup>24</sup> At the current pace, redesigning the remaining notices will take a decade or more. Correcting math error notices should be a priority because of the number of taxpayers affected. Notice clarification would improve compliance and IRS productivity as well.<sup>25</sup>

The IRS continues to expand math error processing without a clear understanding of the true downstream costs. The IRS estimates that notice processing operations cost \$472 million annually, with about 60 percent (\$281 million) attributable to the downstream impact of issued notices (i.e. handling subsequent correspondence, telephone calls, and remittances from taxpayers).<sup>26</sup> The Treasury Inspector General for Tax Administration (TIGTA) recommended that the IRS implement a management information system to track abatements, incorrect assessments, or audit reconsiderations.<sup>27</sup> It has not yet done so. The IRS is working on a reporting system, with a scheduled fiscal year 2003 rollout, to record audit reconsideration information. However, that system will not cover cases abated through non-audit procedures such as math error processing. By excluding math error abatements, IRS cannot accurately calculate the actual administrative costs of the math error program.

<sup>23</sup> IRC § 6213(b).

<sup>24</sup> Notice Modernization Team, Phase I: Notice Operations Baseline – Atlanta, GA February 7, 2001.

<sup>25</sup> Treasury Inspector General for Tax Administration Report, *Increased Management Attention is Needed to Ensure the Success of Future Notice Redesign Efforts*, #2002-30-040, December 2001, page 3.

<sup>26</sup> *Id.* page 1.

<sup>27</sup> Treasury Inspector General for Tax Administration Report, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service*, #2001-40-053, March 2001, page 8.



The IRS plans to include cases subject to the Federal Case Registry in math error processing.<sup>28</sup> This expansion has the potential to cause thousands of taxpayers the burden of undoing an erroneous tax adjustment by IRS. State departments of health and human services are required to submit updates to the Federal Case Registry in June and December of each year. States do not report data in a uniform fashion, and database records do not reflect dates of the state's submissions into the Federal Case Registry. Outdated or inaccurate records may result in tax assessments, which taxpayers must take affirmative steps to correct. The proposed expansion of math error processing to include Federal Case Registry cases will substantially increase the number of math error notices in 2004. Under present circumstances, if math error authority is expanded to include FCR cases, The National Taxpayer Advocate believes that a high percentage of math error notices will require correction at significant resource cost to the IRS and burden to the taxpayer.

#### IRS COMMENTS

IRS administration of math error authority is, and has been, in accordance with the provisions of the Internal Revenue Code. The specificity with which this authority is described in IRC § 6213(g) clearly reflects Congressional intent to authorize IRS to dispose of these taxpayer errors without resorting to examination deficiency procedures. This allows IRS to prevent issuance of erroneous or fraudulent refunds when taxpayers' returns contain the enumerated missing or incorrect entries.

However, we do agree that taxpayers can sometimes find math error notices confusing and that in some cases these notices offer inadequate explanations regarding items that the IRS modified or denied on tax returns.

There are currently four standard notice types that are used primarily to correspond with individual taxpayers regarding errors where math error authority is applied to individual tax returns. Tax Examiners in Submission Processing's Error Correction function may select from approximately 500 predefined and programmed taxpayer notice "literals" (paragraphs) that have been predefined and programmed to explain math errors on individual income tax returns. In an effort to better define the math error conditions, the Service has unintentionally hindered our employees' ability to quickly and correctly identify appropriate notice literals, and thus may contribute to taxpayer confusion.

We also recognize that many low income, elderly or unrepresented taxpayers may be intimidated when they receive any notice from the IRS. This condition is often not resolvable; however, every effort is being made to increase the clarity and accuracy of our notices and improve the math error process.

<sup>28</sup> The Economic Growth and Tax Relief Reconciliation Act; Pub. L. No. 107-016 (H.R. 1936); Title III, Section 303. Amended IRC § 6213(g) to use the math error authority in conjunction with the Federal Case Registry of Child Support Orders to identify non-custodial parents in connection with the earned income tax credit claims.

Regarding taxpayer claims for reversing math error changes on original return processing, Internal Revenue Manual procedures comply with the Internal Revenue Code. Customer Service Representatives are instructed to determine if a claim is unsubstantiated (can not be validated) or substantiated (can be validated). If a taxpayer requests a reversal, up to the amount claimed on the original return and within 60 days of the notice, it is allowed even if it is unsubstantiated. The case is made available for further examination. A substantiated claim can be made at any time. A legislative change would need to occur to change this process. In addition, we are unaware of any reliable management information or quality review data to support the statement in this report that when taxpayers call the IRS 1-800 number and state that they do not agree, "...many times the assistor will inform the taxpayer they need to file a claim, and offer no further explanation."

With regard to IRS use of the Federal Case Register, a Research Team is currently working on the procedures to implement use of this data to preclude duplicate or fraudulent claims of qualifying dependents by non-custodial parents' for purposes of the EITC. IRC § 6213(g), as amended by Public Law 107-016, mandates that the IRS use Federal Case Register data. Potential issues, such as those raised in the National Taxpayer Advocate's report, are being considered as IRS moves to implement this new authority.

#### IRS INITIATIVES TO RESOLVE PROBLEM

IRS has short and long-term initiatives designed to improve taxpayer correspondence and math error authority procedures.

The Notice Process Improvement Initiative Team – Taxpayer Notice Codes/Reasons Codes project is a jointly sponsored effort by Wage & Investment and Small Business/Self Employed to improve the clarity of notices. Since September 2002, the team has eliminated more than 100 obsolete and vague codes. They also identified another 42 codes that can be eliminated during the next phase of the project beginning in January 2003. This will significantly improve field employees' ability to select the correct code with the result that taxpayer understanding of these notices will be improved significantly. The next phase of this project includes re-sequencing notice literals for Error Correction processing to correspond to the tax return. Phase II is expected to be implemented in January 2004 and will assist Error Correction tax examiners in selecting the correct literals for taxpayer notices. Adapting the remaining explanations to individually fit specific taxpayer situations will be extremely challenging due to systemic limitations and may be delayed until modernized computer systems are available.



Over the past few years all of the Math Error Notices have been redesigned. In addition, a separate effort based on Notice Error Rate data will provide ongoing improvements.

The IRS does not have a management information system for tracking non-audit abatements, however during 2002, a research team in Indianapolis was tasked to perform an in-depth analysis of the math error authority process. Information from this analysis will be used to determine the effectiveness of the math error process. Preliminary data from the analysis indicates that some math error conditions have a high rate of reversal due to subsequent taxpayer contact. After the final report is submitted, the data will be used to make improvements to the current process. While not yet final, under consideration are such things as:

- ◆ Adding manual research requirements prior to corresponding with the taxpayer.
- ◆ Initiating taxpayer contact during return processing to resolve potential math errors prior to applying math error authority.
- ◆ Refining the Error Correction programming to eliminate conditions that result in erroneous application of the math error authority.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*We commend the IRS on its initiatives to improve the clarity of notices. The Taxpayer Advocate Service will continue to support the IRS in developing clearer explanations on math error notices. A member of the Taxpayer Advocate Service will serve on the Notice Process Improvement Initiative Team (NPIIT) to ensure that our concerns are addressed.*

*Continued support of the IRS' information systems modernization efforts is essential to resolving this problem. Information systems improvements will provide the IRS greater flexibility to improve its notices in a more timely fashion.*

*However, we remain concerned that the IRS has not yet placed enough emphasis on the process and there are still major weaknesses in its improvement efforts. The current initiatives do not provide for specific information on notices related to a taxpayer's error. We believe the IRS should implement a notice process that uses the line number from the tax return to relate to the math error. Until the IRS implements such a system, taxpayers will continue to experience problems using the math error notice codes to determine the mistakes made on their returns.*

*We look forward to reviewing a copy of the math error study performed by the Office of Research. However, we feel that without implementing a management information reporting system to track abatements to the type of notice/program of the original tax change, the IRS will not be able to readily identify error trends. These trends are critical to providing the proper educational efforts for taxpayers and IRS employees.*



*The burdensome process of reversing math error assessments continues to be a major source of taxpayer contacts within TAS.<sup>29</sup> Data from our Taxpayer Advocate Management Information System (TAMIS) supports this conclusion.<sup>30</sup> Providing additional training to Accounts Management employees to assist them in making a determination regarding math error responses received from taxpayers (i.e. substantiated or unsubstantiated) will ensure that taxpayer rights are protected. Revision of the Internal Revenue Manual and associated job aids to reflect clearer guidance on math error determination will also provide greater protection of these rights.*

*(NOTE: For further discussion of the Service's mathematical and clerical error assessment authority, see Key Legislation Recommendation #3, herein.)*

<sup>29</sup> The total case receipts for major issue codes related to all math error issues were 21,656. (Major Issue Codes 470, 471, 472, 473 and 476) This accounts for 8 percent of all TAS receipts.

<sup>30</sup> The TAS sample review consisted of 414 cases of major issue code 473—Unprocessed Returns with Math Error Issues, between October 1, 2001, and August 30, 2002. The major emphasis of this review was on non-EITC Math Error issues. The review reflected: (1) Taxpayers are unable to identify the errors they made on their returns from the math error notices they receive; and (2) Once the taxpayers identify the errors made, they have difficulty navigating the IRS to correct the errors.



## PROBLEM

### TOPIC #4

## IRS INFORMATION REPORTING PROGRAM

### IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

### DEFINITION OF PROBLEM

The Information Reporting Program (IRP) produces a high volume of tax assessments that the IRS later abates, placing an unnecessary burden on taxpayers.<sup>31</sup> The IRP is by far the largest single source of abatements.<sup>32</sup> The Taxpayer Advocate Service (TAS) has identified other issues that contribute to the problem:

- ◆ The IRS has not fully implemented the Management Information System (MIS) to capture vital statistics about audits and abatements, as recommended by the Treasury Inspector General for Tax Administration (TIGTA).
- ◆ Based on a sample of Taxpayer Advocate Service (TAS) cases, five of the top six tax issues where the Automated Underreporter (AUR) assesses additional taxes are the result of taxpayers being uneducated about income reporting requirements.<sup>33</sup>
- ◆ The IRS continues to experience problems associating documents and recording the timely receipt of taxpayer correspondence, corrected Forms W-2, and 1099, and Forms 1040X to eliminate unnecessary taxpayer contact.
- ◆ Taxpayers are unable to contact IRS employees who are working their IRP cases.
- ◆ AUR employees fail to screen original returns to ensure that the underreported item is not reported on some line on the tax return other than the correct line before issuing the CP 2000.<sup>34</sup> Further, they fail to check prior or subsequently filed returns to determine if the unreported item was reported there.
- ◆ The IRS inconsistently notifies other taxing authorities of increased tax liabilities and is not required to notify them of changes to taxpayer's accounts.

<sup>31</sup> An abatement is a formal bookkeeping entry to record a reduction of tax, penalty, or interest assessments on a taxpayer's account. Abatements reduce the amounts that taxpayers owe and that IRS has a right to collect. Internal Revenue Code section 6404 authorizes IRS to abate an assessment under certain conditions. For example, IRS can abate an assessment because of errors made. A taxpayer can make an error on the original tax return, such as not claiming a deduction. Or, IRS may assess incorrect tax amounts when auditing a return or matching income reported by taxpayers with income reported by third parties (such as employers) on payments made to the taxpayers.

<sup>32</sup> Treasury Inspector General for Tax Administration (TIGTA) Report, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service*, #2001-40-053, March 2001, page iii.

<sup>33</sup> The TAS sample consisted of Major Issue Code 430, Underreporter process, and includes both open & closed cases. The sample size of 235 was based on a population size of 3,693. The sample was completed on July 12, 2002.

<sup>34</sup> Internal Revenue Manual 4.19.3, IMF Automated Underreporter Program. A CP 2000, or Notice of Proposed Adjustment or Overpayment, shows the changes to a taxpayer's income tax return. It is a proposal based on a comparison of the income, payments, credits and deductions reported on taxpayer's tax return with information on these items reported to the IRS by employers, banks, businesses and other payers.

### ANALYSIS OF PROBLEM

The Automated Substitute for Return (ASFR) and Automated Underreporter (AUR) assessments are part of the IRS Information Reporting Program. The ASFR program is responsible for securing tax returns from individuals who, based on third-party information, received taxable income but did not file a return. The AUR program is responsible for reconciling third-party information to income and certain deductions reported on filed tax returns.<sup>35</sup>

The Information Reporting Program (IRP) contacted more than 2.5 million taxpayers in fiscal year 2001 and assessed a total of \$3.88 billion.<sup>36</sup> A significant portion of these assessments will be subsequently abated when the IRS acts on taxpayer correspondence, processes amended returns (Forms 1040X), or receives corrected Forms W-2 and Forms 1099. Some assessments result from taxpayers' lack of knowledge about how to properly report income, and many will be subject to abatement. Taxpayers find that understanding the errors, gathering any supporting documents, communicating changes with IRS employees, and otherwise responding to IRS notices is burdensome.<sup>37</sup> In addition, taxpayers' problems are compounded when the IRS notifies the appropriate state or other taxing authority of increased tax liabilities, but does not notify the state or authority of countervailing reductions in tax or income. As a result, many taxpayers are required to prove the abatement to these local taxing authorities. The IRS currently shares information with state tax agencies through mutually negotiated implementing agreements pursuant to Internal Revenue Code section 6103(d).<sup>38</sup>

Taxpayers who receive an increase in tax must go through a complicated, time-consuming audit reconsideration process to resolve their issue. This process, in which the IRS reconsiders the validity of a prior assessment, provides the taxpayer an opportunity to present information not considered in the original audit. Many audit reconsiderations result in the IRS abating the initial tax assessment.

The Treasury Inspector General for Tax Administration (TIGTA), in a report entitled *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service*, attributed approximately 81,000 or 76 percent of all abatements to assessments made through ASFR or AUR programs.<sup>39</sup> TIGTA recommended that the IRS put in place a man-

<sup>35</sup> Treasury Inspector General for Tax Administration (TIGTA) Report—*Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service* – #2001-40-053, March 2001, page ii.

<sup>36</sup> IRS Data Book 2001, Table 25, page 26.

<sup>37</sup> General Government Division, U.S. General Accounting Office, *Tax Administration – IRS Can Help Taxpayers Reduce the Need for Tax Abatement*, Report to Congressional Requesters, GAO-01-328, page 10.

<sup>38</sup> IRC § 6103 (d) (1). Disclosure of federal returns and return information to a state or local tax agency will be restricted to the agency's justified need for and use of such information for state tax administration.

<sup>39</sup> See fn 35, page iii.



agement information system (MIS) to identify volumes of audit reconsideration cases, abatements by type, account characteristics, and the reasons for abatements, but to date no such system has been implemented. This type of system could provide the impetus to identify trends and assist in developing corrective actions to reduce the volume of abatements and audit reconsideration cases.<sup>40</sup> Existing reports do not track the number of accounts affected by issue, only the total dollar amounts. As a result, the current reporting system is not helpful in accounting for the volume of taxpayers impacted by each specific issue.

Armed with detailed information, IRS could better analyze ways to improve voluntary compliance through education, outreach, improved services, and simpler forms; and improve resource allocation and training of IRS staff.<sup>41</sup>

In a recent sample of TAS cases, five out of the top six tax issues where AUR assesses additional tax result from taxpayer confusion about income reporting requirements.<sup>42</sup> There is little correlation between the errors identified in AUR and educational efforts. For example, taxpayers who receive payments from financial institutions, the Social Security Administration, and state unemployment agencies are often unaware of the tax implications at the time they receive the funds and fail to properly report the payments. Based on analysis of the Taxpayer Advocate Management Information System (TAMIS) database and AUR management reports,<sup>43</sup> the following are the most common issues:

1. Underreported Wages
2. Non-Employee Compensation
3. Unemployment Compensation
4. Social Security Benefits
5. Interest
6. IRA Premature Withdrawal Excise Tax

#### Example

Taxpayer A, who is under 59 1/2 years old, withdrew funds from an IRA account. She arranged for tax withholding on the withdrawal and reported the withholding on her income tax return. The financial institution did not inform Taxpayer A about the 10 percent IRA Premature Withdrawal Excise

<sup>40</sup> Treasury Inspector General for Tax Administration (TIGTA) Report—*Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service* – #2001-40-053, March 2001, page iii.

<sup>41</sup> U.S. General Accounting Office, *Tax Administrations, Information on Selected IRS Tax Enforcement and Collection Efforts*, Testimony before the Committee on Finance U.S. Senate, GAO-01-589T, page 8.

<sup>42</sup> The TAS sample consisted of Major Issue Code 430, Underreporter process—includes both open & closed cases. The sample size of 235 was based on a population size of 3,693. The sample was completed on July 12, 2002.

<sup>43</sup> Tax Year 2000, Underreporter Inventory Reports, Tax Years 1998 through 2000.

Tax. Taxpayer A was unaware of the additional early withdrawal tax and did not report it. After filing her return, Taxpayer A was then contacted by AUR when the IRS' document-matching program revealed the error. This could have been prevented if Taxpayer A had been informed of the tax consequences at the time of the withdrawal.

The IRS continues to experience problems with timely handling of taxpayer correspondence, corrected Forms W-2 and Form 1099 information, and processing Forms 1040X. The IRS processed 2.9 million corrected Forms W-2 in tax year 2001,<sup>44</sup> over 3.7 million amended returns (Form 1040X),<sup>45</sup> and in excess of one billion information returns from third-party payers such as banks and employers.<sup>46</sup> Research indicates that roughly 30 percent of abatement requests received in the TAS sample result from Form 1040X, W-2C, or Form 1099C being sent to the IRS but not posted timely or not properly associated with the taxpayer's account.<sup>47</sup>

### Example

Taxpayer B filed his original return in February, then received an additional W-2 and filed a Form 1040X in July, reflecting additional income and paying the additional tax. In August, Automated Underreporter (AUR) issued a CP 2000, proposing an adjustment to Taxpayer B's account. The IRS had received the original Form 1040X in July, but did not post it to the taxpayer's account. Taxpayer B was required to forward an additional copy of the Form 1040X to the AUR tax examiner to resolve the issue. Although Taxpayer B did not include all of his income on this original return and owed additional tax, Taxpayer B did correct the issue and file an amended return. The timing of IRS' processing of the corrected document caused additional burden on this taxpayer.

In March, Taxpayer C received a Form W-2C from her employer showing an increase in withholding. Taxpayer C filed her return in April 2000 showing the increase. In January 2001, AUR disallowed this amount from the original tax return. The IRS did not process the tape from the employer showing the W-2C corrections for the company's employees until late January. A copy of the W-2C from the taxpayer resolved the issue. However, the timing of IRS' processing these corrected documents caused a burden on taxpayers.

<sup>44</sup> Report 413-06-41, CAWR W-2 Control Report, Tax Year 2001.

<sup>45</sup> IMF Amended/Duplicate Returns—Briefing Paper, Jacksonville Office of Research, March 2002.

<sup>46</sup> General Government Division, U.S. General Accounting Office, Tax Administrations, IRS' Use of Nonaudit Contacts, Report to Congressional Requesters, GAO/GGD-00-7, March 2000, page 19.

<sup>47</sup> TAS Sample, July 12, 2002. See fn 12.



IRS procedures instruct AUR employees to thoroughly screen the original return to ensure that the underreported issue is not reported on another line of the tax return before issuing the CP 2000.<sup>48</sup> Additionally, the taxpayer might have reported the income on a subsequent or prior year return. Without a comprehensive review of the taxpayer's entire filing record, a taxpayer may be unnecessarily burdened in the process.

### Example

Taxpayer D's employer (third party) reported a \$7,000 lump-sum payment on a Form W-2 in 1999, even though the taxpayer did not receive the payment until January 2000. Taxpayer D reported the lump-sum payment on his 2000 return. The IRS issued a CP 2000 since the taxpayer did not report the lump-sum payment in 1999. AUR did not review Taxpayer D's subsequent year tax return to determine if he reported the income in another year, which would have changed the nature of the inquiry to the taxpayer.

The IRS does notify other taxing authorities of increased tax liabilities, but is not notifying them of reductions in tax liability and income.<sup>49</sup> The exchange of confidential tax information between the IRS and the various states is intended to increase tax revenues and taxpayer compliance, and reduce duplicate resource expenditures.<sup>50</sup> Implementing agreements are developed and negotiated with each state taxing agency wishing to receive federal returns and return information.<sup>51</sup> Each agreement provides for the mutual exchange of tax data between a specific local tax agency and the IRS. Depending on these separate agreements, the IRS provides information to the local authorities when a change to the taxpayer's account increases tax. However, if the IRS later abates the increase, it is not required to notify the appropriate local taxing agency of the change. Consequently, when the IRS abates tax, taxpayers must obtain for the local authorities acceptable proof from the IRS that the liability has been lowered.

### Example

Taxpayer E resolved an AUR case that was caused by his employer erroneously issuing multiple Forms W-2. Six months later, Taxpayer E was contacted by his state's Department of Revenue about the same issue. Taxpayer E was required to substantiate the abatement for the state tax agency because the IRS did not provide the abatement information to the state.

<sup>48</sup> Internal Revenue Manual 4.19.3, Automated Underreporter.

<sup>49</sup> IRC § 6103(d).

<sup>50</sup> IRM 11.3.32, Disclosure to States for Tax Administration Purposes.

<sup>51</sup> Policy Statement P-1-35 dated January 1, 1979.

**IRS COMMENTS**

The Information Reporting Program is a major program used by the IRS to ensure accurate income reporting and appropriate return filing. As such, the IRS continually looks for opportunities to improve program efficiency and reduce any associated taxpayer burden.

The IRS recognizes the taxpayer burden and operational costs associated with assessing tax that must be subsequently abated. While reducing the number of abatements related to compliance programs is always desirable, to understand the scope of this issue as it relates to Information Reporting Program, it should be noted that the 81,000 abatements associated with the Automated Underreporter (AUR) Program and the Automated Substitute for Return (ASFR), as reported by the National Taxpayer Advocate, resulted from more than 2.5 million taxpayer contacts and represent approximately three percent of all program contacts. It should also be noted that those abatements related to the ASFR program are not surprising, since when the Service is forced to assess tax using substitute-for-return procedures, the assessment is based on a single/married-filing-separate filing status (as required by law) even though the taxpayer may ultimately be entitled to a more advantageous filing status and/or greater deduction amounts. To further reduce the number of abatements, the IRS will continue to evaluate all program information (including the expanded information recommended by TIGTA when it is available) to identify systemic issues that may contribute to the number of abatements related to the Information Reporting Program.

Providing taxpayers with the education and information required to accurately prepare their tax returns is one of the primary missions of the Internal Revenue Service. The National Taxpayer Advocate's report indicates that taxpayers do not fully understand their income reporting requirements for five of the six major tax issues resulting in AUR assessments. The sample reviewed by the National Taxpayer Advocate estimates that approximately six percent of the AUR cases seemed to be caused by the taxpayer's confusion about income reporting requirements. To evaluate the size of this problem, it is important to note that for the last AUR program year more than one billion information returns were filed and matched to income reported on tax returns and as a result 1.8 million taxpayers were identified and contacted to resolve questions about correct income reporting. The National Taxpayer Advocate sample would indicate that approximately 108,000 of the taxpayers contacted might not have fully understood their income reporting requirements. While the IRS will continue to improve taxpayer education and outreach (including information on reporting requirements) wherever possible, the IRS must always balance available resources with the magnitude of the problem when considering new initiatives.



As previously noted, more than one billion information returns were processed and matched in fiscal year 2002. In addition, over six million corrected and/or amended information and income tax returns were processed. AUR program information is updated weekly to ensure that corrected and amended returns are recorded and considered as soon as they are included in the taxpayer's electronic record. IRS acknowledges that there may be instances where the timing of processing corrected and amended returns as it compares to the timing for updating the AUR program information may result in a taxpayer contact that might otherwise be unnecessary. However, it does not appear that this problem occurs either routinely or frequently (the data in the National Taxpayer Advocate Report indicates that 30 percent or 24,300 of the total abatement requests received related to the Information Reporting Program are the result of processing delays associated with corrected and/or amended returns).

The IRS agrees that providing taxpayers with telephone access to resolve AUR cases needs improvement. The National Taxpayer Advocate's report indicates that taxpayers continue to experience difficulty in contacting the IRS employees assigned to their cases. The IRS completed the implementation of toll free numbers for taxpayers to contact the IRS about AUR notices during fiscal year 2001. Since fiscal year 2001, the number of calls to the AUR toll free number has doubled while the number of calls answered has remained constant. This increased workload without comparable resource increases challenges the ability of the Service to provide an acceptable level of telephone access for taxpayers contacted in the AUR program. Improving telephone access for the AUR program continues to be a top priority for Compliance leadership. In an effort to improve the efficiency of the AUR telephone system, the IRS has implemented automated messages on the toll free lines to provide improved access for taxpayers with general questions that can be satisfactorily answered without talking to a tax examiner/assistor. While the IRS believes that additional resources are needed during peak program periods to effectively handle taxpayer calls, in an effort to maximize the use of existing resources, an Inventory Management Tool was implemented in fiscal year 2002 to enable AUR management to more consistently match available resources with projected telephone demand.

The National Taxpayer Advocate report indicates "AUR employees fail to screen the original return to ensure that the underreported item is not reported on some line on the tax return other than the correct line before issuing the CP 2000. Further, they fail to check prior or subsequent filed returns to determine if the unreported item was reported there." In general, the IRS does not agree with this observation. While no screening process is perfect, it is incorrect to say that cases are not screened to determine if the income in question is reported anywhere on the return before contacting the taxpayer. In fact, the



IRS clearly invests significant resources in both systemic and manual screening of AUR cases in an effort to resolve discrepancies without taxpayer contacts wherever possible. In fiscal year 2002, more than 15 million returns were systemically screened for mismatches and after this screening, three million of these cases were then delivered to the 6 campuses handling AUR cases for manual screening by IRS personnel. This second screening is designed to ensure that the unreported amount cannot be found anywhere on the return before contact is made with the taxpayer. During this manual screening process almost 1.3 million discrepancies were resolved and notices were then sent to the remaining 1.7 million taxpayers. Approximately 24 percent of the taxpayers contacted were able to provide information to resolve the discrepancies while approximately 50 percent of those contacted agreed with the IRS that the amount had not been properly reported, and the remaining 26 percent either did not agree with the IRS determination or failed to respond to the IRS notice.

To measure the success of the AUR screening and notice process, the IRS has a quality review system at each campus and for fiscal year 2002 an accuracy level of 94.5 percent was reported. To ensure effective screening, training is routinely provided to all AUR personnel on screening activities and techniques and additional training may be done if the quality review data indicates problems with screening at a specific campus.

The other National Taxpayer Advocate concern related to screening deals with the lack of a requirement for tax examiners to check prior and subsequent returns to determine if the unreported amount may have been reported on these returns. The IRS agrees that this is not part of the current screening process due to the resource and time issues associated with this practice using current systems. However, to the extent that a taxpayer responds to the initial notice and indicates that the income was reported on a prior or subsequent year return, the tax examiner would give full consideration to this information in resolving the case.

#### IRS INITIATIVES TO RESOLVE PROBLEM

- ◆ Management will continue working to complete the programming required to provide the data extract recommended by TIGTA that will capture the vital statistics needed to evaluate the causes of abatements and develop corrective strategies. This system is scheduled to be operational in December 2002.
- ◆ The IRS will continue to work through our taxpayer education and outreach operations to identify new and improved strategies for educating taxpayers about their income reporting requirements.



- ◆ A number of internal studies to improve telephone access in the AUR program have been initiated. These studies are currently exploring (1) the identification of alternative means for meeting the taxpayers need to talk with IRS personnel, (2) the reasons for taxpayer calls, and (3) the patterns and reasons for call abandonment and callbacks.

In response to the National Taxpayer Advocate's concern about the AUR screening process, the IRS will do additional analysis by selecting a sample of the more than 400,000 cases that were resolved by contacting the taxpayer to determine if these cases should have been resolved in the screening process. Based on the outcome of this analysis, corrective actions will be developed as needed.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*We commend the IRS on its initiatives to reduce the burden on taxpayers relative to this issue. The Taxpayer Advocate Service (TAS) will continue to support the IRS in developing clearer and more easily understandable notices by providing the IRS with feedback from a taxpayer's perspective.*

*Although the percentage of Automated Underreporter (AUR) abatement compared to assessments may not be a high number based on the overall inventory, this issue continues to be a major source of taxpayer contacts with TAS. TAS will support the IRS' efforts to develop a management information system that will capture all AUR assessments and abatements, including the number of and specific reason for the abatements. TAS has recently partnered with the Office of Research and obtained abatement data related to AUR cases by type for three prior years. TAS will share the results of this data with AUR to assist its educational efforts for taxpayers.*

*To help reduce the problem of unassociated amended or corrected documents, we recommend that the IRS implement procedures that require amended returns or corrected Forms W-2 and 1099 to be entered into IRS systems and databases as soon as they are received. The IRS would then immediately transfer this data electronically to the AUR system. The IRS could use this data as a trigger to hold the issuance of the CP-2000 until the amended return or form is fully processed. To assist this effort we would suggest that the IRS implement electronic filing capabilities for Form 1040X for taxpayers who file their Form 1040 electronically.*

*We recognize the challenges that the IRS faces in providing an appropriate level of telephone access to taxpayers. However, we remain concerned about this issue. By collecting and analyzing data that would identify the various root causes of the problems taxpayers face in contacting the IRS, the IRS would be able to develop long term solutions. From calls received in TAS, we believe that one of the major reasons taxpayers call AUR is because the AUR notice (CP 2000) is seven to 10 pages long; they simply cannot decipher the notice. The IRS has recognized that the current AUR notice (CP*

2000) is confusing and difficult to understand, and has instituted a redesign effort. The IRS is using taxpayer focus groups and external contractors to assist in this project. We applaud these efforts. However, the IRS will not completely implement its current redesign until fiscal year 2004.

We are extremely pleased to see IRS' planned initiative to review more than 400,000 cases that were resolved by contacting the taxpayer to determine if these cases should have been resolved in the screening process. We look forward to reviewing the results. This is an excellent example of how IRS can use historical data to identify procedural deficiencies.

In its response, the IRS did not address the issue of the exchange of tax information with city or state tax authorities. It is imperative that the IRS enter into standard implementing agreements with all state and city tax authorities, especially because of the consolidation of programs and removal of the old IRS geographic boundaries. This would ensure that the IRS shares assessment and abatement information in a consistent manner with all participating agencies. The current process increases taxpayer burden and reduces the effectiveness of tax administration at the external tax agencies.



## PROBLEM

### TOPIC #5

### PROCESSING CLAIMS FOR REFUND

#### IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

#### DEFINITION OF PROBLEM

IRS campuses (formerly Service Centers) cannot locate refund claims that their systems indicate the agency has received. This forces taxpayers to resubmit the claims and wait longer for refunds, while also exacerbating the campuses' inventory problems.

Further, the IRS also exceeds its own timeframe by taking longer than eight weeks, and sometimes more than 12 weeks, to process claims for refund. Refund processing is further complicated by the fact that IRS campuses use different procedures to process claims. Finally, there are no guidelines for IRS employees that allow taxpayers to provide proof of mailing when a claim is lost or return is amended before an appeal is made.<sup>52</sup>

#### ANALYSIS OF PROBLEM

In fiscal year 2001, taxpayers filed 3,750,963 Forms 1040X, Amended U.S. Individual Income Tax Return, representing a 16 percent increase over FY 2000.<sup>53</sup> A study conducted in FY 2001 by IRS Research and the Office of Program Evaluation and Risk Analysis (OPERA) revealed the increase in amended tax returns was primarily due to taxpayers filing original returns electronically, then later claiming earned income credits on amended returns.<sup>54</sup> As stated in the Form 1040X instructions, the normal timeframe for processing a claim is eight to twelve weeks.<sup>55</sup> Taxpayers contact TAS when it takes longer than that.

Campuses process refund claims in two ways. One method establishes a tracking control, but requires several labor-intensive steps that extend the processing time.<sup>56</sup> This could relieve burden on taxpayers by not requiring them to reconstruct or resubmit a copy of the originally filed claim or amended return. However, it can also further delay the refund beyond the 12-week timeframe. The other method of processing provides faster refunds, but does not establish tracking measures and is thus more susceptible to lost claims.

<sup>52</sup> IRC § 7502 and Internal Revenue Manuals 20 and 25 cover taxpayer burden for timely mailing. The Internal Revenue Manuals (IRM) 21 and 3.11 used by Account Management and Submission Processing employees do not address burden of proof for timely mailing.

<sup>53</sup> W&I Briefing Paper drafted by the Jacksonville Research Office dated March 2002 from Electronic Tax Administration (ETA).

<sup>54</sup> W&I Briefing Paper drafted by the Jacksonville Research Office dated March 2002 from ETA.

<sup>55</sup> Form 1040X, Amended U.S. Individual Income Tax Return Instructions and IRM 21 (45-Day Interest Free Period).

<sup>56</sup> IRM 3.11.6.1, Submission Processing Returns and Document Analysis. Tracking control refers to Integrated Submission Remittance Processing (ISRP) and Integrated Data Retrieval System (IDRS).

When this happens, the burden falls on the taxpayer to reconstruct or resubmit a copy of the original claim or amended return.<sup>57</sup>

Some claims may be disallowed because the time to claim the refund has lapsed.<sup>58</sup> Taxpayers that exercise their right to appeal are requested to provide proof of mailing. There are no IRS guidelines requiring the taxpayer to provide proof of mailing for a lost claim or amended return prior to filing an appeal.<sup>59</sup> If there is any indication that the IRS received an amended return and cannot locate the original, the taxpayer is asked for a new copy. The IRS then uses the received date, rather than the mailed date, of the original filed claim to process the new copy.<sup>60</sup>

The Taxpayer Advocate Service (TAS) performed an in-depth review of a random sample of 271 cases from the TAS inventory.<sup>61</sup> They consisted of 90 percent individual and 10 percent business returns.

**TABLE 1.5.1**  
**TAS REFUND CLAIM CASES**

Individual Tax Return Related Forms Filed (90%)		
Form	Number Reviewed	Percent of Total
1040X, Amended U.S. Individual Income Tax Return	155	57%
8379, Injured Spouse Claim And Allocation	71	26%
Various other individual tax forms	19	7%
Business Tax Return Related Forms Filed (10%)		
Various business tax forms	26	10%

<sup>57</sup> NT Electronic Online/Output Network System Report from Oct. 1, 2000 to Sept. 30, 2001. The Deputy National Taxpayer Advocate is chair of the TAS/IRS cross-functional team working on establishing standard procedures across IRS campuses.

<sup>58</sup> TAS Quality Sampling Report of major issue code (MI) 330 cases (Random sample of 271 cases reviewed, three cases were applicable) from March 2000 to March 2002.

<sup>59</sup> IRC § 7502 and Internal Revenue Manuals 20 and 25 cover taxpayer burden for timely mailing. The Internal Revenue Manuals 21 and 3.11 used by Account Management and Submission Processing employees do not address burden of proof for timely mailing.

<sup>60</sup> The indicator for an amended return shows as transaction code (TC) 971/977 on the Integrated Data Retrieval System (IDRS); Internal Revenue Manual 21.

<sup>61</sup> TAS Quality Sampling Report of MI 330 cases (Random sample of 271 cases reviewed).



As shown in Table 1.5.1, the majority of the claims fell into two major categories.

- ◆ Fifty-seven percent of the claims filed for refund were on Form 1040X. Sixty-seven percent of these cases required handling in the IRS campuses' Accounts Management Department. These cases were assigned to the department because an incorrect adjustment was input or they met other Accounts Management criteria. The type of tax adjustment requiring the skills of an Accounts Management employee and the tax changes requested by the taxpayers filing these amended returns varied; however, when 41 percent of these amended returns came to TAS, they were open in the Accounts Management inventory waiting to be assigned and processed by an individual employee.<sup>62</sup>
- ◆ Twenty-six percent of the claims filed for refund were on Form 8379, Injured Spouse Claim and Allocation. The Taxpayer Advocate Service reviewed 71 Form 8379 cases. The processing time for the Form 8379 should be eight weeks.<sup>63</sup> Taxpayers contacted TAS because the injured spouses had not received the refund and it had been longer than the eight-week timeframe.

The taxpayer has the option to file Form 8379 electronically with his or her Form 1040, Individual U.S. Income Tax Return, or to prepare a paper document and mail it with his or her Form 1040. The processing of Form 8379 is not an automated system and therefore must be manually verified and computed. These procedures may add an additional eight weeks to the Form 1040 processing.

#### IRS COMMENTS

While IRS' objective is to certainly have an error free refund claim process, we do not concur that this is one of the most serious problems facing the taxpayer. Forms 1040X are screened and routed to various functions at our campuses. Claims can be routed through Integrated Submission and Remittance Processing (ISRP) or the Integrated Data Retrieval System (IDRS). Since input through ISRP delays the process, campuses have been encouraged to use IDRS. This will be mandated in the IRM once campuses have adequate IDRS terminals. Although claims may be lost using either of these methods, it is rare. The IRS would need more information concerning the Taxpayer Advocate's comments on "lost claims" reflected in this report.

<sup>62</sup> Internal Revenue Manuals 3.11.6 and 21.5; Submission Processing and Accounts Management work amended returns.

<sup>63</sup> Form 8379, Injured Spouse Claim and Allocation.

### IRS INITIATIVES TO RESOLVE PROBLEM

IRS has focused attention on resolving more claims for refund within the Submission Processing Center while increasing consistency and improving timeliness in processing of these cases. Submission Processing Tax Examiners were trained to resolve additional issues found on these claims. In August, a joint conference was held to discuss timeliness, reporting and tracking issues, quality review, and training and workflow. Consistent monitoring of the program will reflect a more accurate volume and disposition and help reduce the timeframe for issuing refunds to taxpayers.

Electronic Tax Administration is doing a review to determine the functionality of receiving Form 1040Xs electronically. The Form 8379, Injured Spouse Claim, is now accepted electronically when filing online, which improves service to taxpayers. A new Correspondence Imaging System (CIS) is being piloted in Austin in 2003, which will also improve the timeliness of claims processing.

### TAXPAYER ADVOCATE SERVICE COMMENTS

*The National Taxpayer Advocate (NTA) commends the IRS for the significant number of tax returns processed, taxpayer inquiries answered, and other account problems handled every tax year. TAS receipts are minimal by comparison – in fiscal year (FY) 2002, TAS received approximately 227,000 cases.<sup>64</sup> The main focus in reviewing the TAS inventory is to identify key areas of TAS case-work and describe, beyond the numbers, what initiatives we are undertaking with the Operating Divisions and Functional units to reduce, if not eliminate, these cases. Of the FY 2002 receipts in our TAMIS data base, “claims for refund” cases led all other categories.<sup>65</sup>*

*The National Taxpayer Advocate agrees with the IRS that IDRS is the most expeditious method of issuing taxpayer refunds. IDRS lacks only a systematic clerical filing and tracking mechanism among the campuses. If the IRS adopts uniform tracking and filing systems along with the requirement to input the transaction code (TC 971) showing receipt of the claim and the adjustment for refund to IDRS, then the IDRS method would definitely become the most efficient method of providing faster refunds and tracking claims.<sup>66</sup> When claims are handled manually from department to department, they are always subject to being misplaced. Taxpayers contacted TAS because the IRS took longer than eight weeks to process their refunds. Thirty-nine percent of these amended returns received in TAS met the Accounts Management Function criteria for “lost” cases.<sup>67</sup> The received dates of the claims were determined on the face value of the taxpayer’s statement to TAS that the claim was*

<sup>64</sup> TAMIS (Taxpayer Advocate Management Information System) data, case receipts for fiscal year 2002.

<sup>65</sup> *Id.*

<sup>66</sup> Internal Revenue Manuals 3.11.6.1.5 (TC 971 Action Codes), 3.11.5.1.6 (IDRS Input, ISRP Input, and G Coding), and 3.11.6.2 (Priority Routing and Processing) do not cover the clerical functions such as filing, batching, and routing claims to IRS functions. Each campus uses local procedures.

<sup>67</sup> TAS quality sampling of MI 330 cases (random sample of 271). These claims met the criterion for Accounts Management Function (AFC) cases in the IRM 3.11.6.2.1, Priority Routing.



mailed to the IRS by a specified date. IDRS showed no open control in a functional area or a Transaction Code (TC) that indicated the claims were received.

The National Taxpayer Advocate also applauds the Wage and Investment Business Division for rolling out the Correspondence Imaging System (CIS) in Austin, Texas in 2003. The CIS will solve the lost claim problem, the inconsistency of batching and filing among campuses, and the other problems associated with paper inventories, such as extensive manual handling and controlling. The CIS scans correspondence and the Forms 1040X, saves the documents, and will be available at all times. Most importantly, the combination of using the IDRS method and CIS would improve the refund processing time and save money in storage and shipping.

Currently, the taxpayer provides proof of mailing after the claim for refund is formally disallowed. The National Taxpayer Advocate recommends that IRS Operations place more emphasis on the importance of providing proof of mailing prior to filing an appeal. The proof of mailing ensures taxpayers receive proper interest from the date of the original filed claim, discourages the IRS from disallowing the claim, and ultimately, eliminates the need for the taxpayer to file an appeal to recoup his refund.

At this time, the only option for filing the Form 1040X is mailing the paper document to the IRS. The Electronic Tax Administration has studied the feasibility of electronic filing. However, the ETA found that implementation of this proposal is being hampered by the IRS requirement for the taxpayer to explain in writing the reasons for the tax changes, on the second page of the claim.<sup>68</sup> The National Taxpayer Advocate recommends that numerical electronic codes substitute for the written explanation now required in Part II of the Form 1040X.

Providing the electronic filing option for Form 1040X would increase the likelihood that the IRS will receive the claim. It would also reduce mathematical errors, allow computers to check the amended figures against the original figures on the system, and deliver faster refunds to taxpayers.

Electronic filing of Form 8379, Injured Spouse Claim and Allocation, speeds up receipt of the claim but still requires an IRS employee to manually compute the refund online. The manual computation adds an additional four to eight weeks to the Form 1040 processing timeframe. The National Taxpayer Advocate recommends that the computation of Form 8379 be automated. The entire process would then be completed in the normal Form 1040 processing timeframe.

A Systemic Advocacy project team has completed a proposal to completely automate the manual computation for both the electronic and paper filed injured spouse claims. This eliminates the need for manual computations, allowing the taxpayer a more expeditious refund. The National Taxpayer Advocate welcomes the opportunity to partner with the IRS in implementing the above proposal.

<sup>68</sup> W&I Briefing Paper drafted by the Jacksonville Research Office, dated March 2002, from ETA.



## PROBLEM

## TOPIC #6

## EITC ELIGIBILITY DETERMINATIONS CAN BE MADE LESS BURDENSOME

## IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

## DEFINITION OF PROBLEM

The Code of Federal Regulations authorizes the IRS to request substantiation of items claimed on a tax return.<sup>69</sup> For the child-based Earned Income Tax Credit (EITC), a taxpayer must be prepared to substantiate any or all of eleven of fifteen eligibility criteria.<sup>70</sup>

These are listed in IRS Publication 17.<sup>71</sup> The tax return or return information must satisfy the following requirements:

- 1) The taxpayer, his or her spouse, if married, and children, if applicable, must have a valid identification number.<sup>72</sup>
- 2) If married (under IRC §7703) the taxpayer must file a joint return.<sup>73</sup>
- 3) The taxpayer must be a U.S. citizen or have resident alien status, or be a nonresident alien married to a U.S. citizen or a resident alien, and elect to be treated as a resident.<sup>74</sup>
- 4) The taxpayer must have earned income.<sup>75</sup>
- 5) The taxpayer must satisfy income thresholds.<sup>76</sup>
- 6) The taxpayer must have limited investment income.<sup>77</sup>
- 7) The taxpayer must meet specific requirements if two or more taxpayers can claim the qualifying child.<sup>78</sup>
- 8) The taxpayer cannot be the qualifying child of another taxpayer.<sup>79</sup>

<sup>69</sup> 26 C.F.R § 1.6001-1 Records, Current through P.L.286 approved 11/06/2002.

<sup>70</sup> Four additional rules apply to “income only” EITC.

<sup>71</sup> IRS Publication *Your Federal Income Tax For Individuals*; TAX GUIDE 2001; pages 244-249.

<sup>72</sup> IRC §32(c)(1)(F); § 32(c)(3)(D).

<sup>73</sup> IRC § 32(d).

<sup>74</sup> IRC § 32(c)(1)(E). The term “eligible individual” shall not include any individual who is a non resident alien...unless such individual is treated...as a resident...by reason of an election under subsection (g) or (h) of section 6013.

<sup>75</sup> IRC § 32(c)(2)(A).

<sup>76</sup> IRC § 32(a)(2).

<sup>77</sup> IRC § 32(i).

<sup>78</sup> IRC § 32(c)(1)(C).

<sup>79</sup> IRC § 32(c)(1)(B).



- 9) The qualifying child must meet a relationship test.<sup>80</sup>
- 10) The qualifying child must meet a residency test.<sup>81</sup>
- 11) The qualifying child must meet age requirements.<sup>82</sup>

The complexities, costs and intrusiveness associated with obtaining third party documentation impose an economic and sometimes emotional burden on low income taxpayers asked to substantiate EITC eligibility, dependency exemptions, head of household filing status, the child tax credit or the child and dependent care credit.

#### ANALYSIS OF PROBLEM

Intrusiveness, complexity and inconsistency in administering the tax laws have been identified as major causes of difficulties in substantiating eligibility for the EITC and other family status tax provisions. The problems can be summarized as follows:

- ◆ Documentation requirements impose a burden on low income taxpayers.
- ◆ There is a lack of consistency by the IRS in accepting verification of documents and other information.
- ◆ Communication gaps exist between the IRS and low income taxpayers during EITC audits.

#### Documentation Requirements Impose a Burden on Low Income Taxpayers

Documentation required to prove residency and relationship in qualifying for the EITC add both an administrative and financial burden for low income taxpayers. At times, it can also take an emotional toll.

Internal Revenue Code section 32 states that to claim a child for EITC purposes, the child must be related to the taxpayer<sup>83</sup> or be an eligible foster child placed with the taxpayer by an authorized placement agency.<sup>84</sup> The child must also live with the taxpayer in the United States for more than half of the tax year.<sup>85</sup>

“Horror” stories sometimes arise when taxpayers try to secure documentation. Though not the norm, they do illustrate the intrusive and, sometimes inequitable nature of the

<sup>80</sup> IRC § 32(c)(3)(B).

<sup>81</sup> IRC § 32(c)(3)(A)(ii).

<sup>82</sup> IRC § 32(c)(3)(C).

<sup>83</sup> IRC § 32 (c)(3)(B) Relationship test. An individual bears a relationship to the taxpayer if such individual is a son, daughter, stepson, or stepdaughter, or a descendant of any such individual, a brother, sister, stepbrother, or stepsister, or a descendant of any such individual, who the taxpayer cares for as the taxpayers own child.

<sup>84</sup> IRC § 32(c)(3)(iii) Eligible foster child. The term eligible foster child means an individual who is placed with the taxpayer by an authorized placement agency, and the taxpayer cares for as the taxpayer’s own child.

<sup>85</sup> IRC § (c)(3)(A)(ii) The term “qualifying child” means, with respect to any taxpayer an individual who has the same principal place of abode as the taxpayer for more than one-half of such taxable year.

process, and demonstrate the necessity of revising and simplifying guidelines for substantiating eligibility. Examples follow:

- ◆ The IRS deemed a taxpayer not qualified for EITC because an unrelated taxpayer living in a different apartment in the same complex had a higher adjusted gross income.
- ◆ A taxpayer was not permitted to use a rental agreement to substantiate his residence and that of his children because the landlord did not include the rent received as income for the year in question.

More than six months residency is required to claim a child for EITC purposes, but a school transcript may show the school term extending from August of one year through May of the year in question. Therefore, because only five months of residency was established in the current year, EITC is disallowed or taxpayers are asked to secure a second transcript.<sup>86</sup>

Some documentation requested need not be obtained directly from taxpayers, as eligibility can often be determined from internal (IRS) sources or other government agencies. For example, IRS has access to Social Security Administration (SSA) information that includes:

- Taxpayer name
- Date and place of birth
- Other names used
- Citizenship information
- Legal Alien- authorized to work
- Legal alien - not authorized to work
- Disability status
- Date of death
- Names of biological parents including mother's maiden name.<sup>87</sup>

Recognizing that this information is available, the IRS will, beginning in the 2003 filing season, stop asking taxpayers to furnish birth certificates of their children, including adopted children, to prove relationship. However, examiners will still request birth certificates to verify biological grandparent and other familial relationships.

<sup>86</sup> The 'disallowance of school records' issue was reported in the 2001 National Taxpayer Advocate Report to Congress. However, Local Taxpayer Advocates raised it again in response to a National Taxpayer Advocate request for Most Serious Problems facing taxpayers during fiscal year 2002.

<sup>87</sup> IRM 2.3.33.2 Command Code ACTRA. Exhibit 2.3.33-16 Command Code ACTRA -NUMIDENT Transcript with Social Security Administration (SSA) data.



**Lack Of Consistency In Accepting Verification of Documents and Other Information.**

Lack of consistency in requiring proof of EITC eligibility continues to plague taxpayers, tax return preparers, and the IRS during the EITC audit process. At times and in some locations, an oral statement from third party is acceptable. In others, the taxpayer must furnish a written statement from the service provider on letterhead stationery. In some instances, examiners ask that statements of third parties be notarized. Examiners may insist on receiving all documents in a list of items while other examiners may accept one item in verifying residency of the qualifying child.

Confusion resulting from the differing definitions of a “qualifying child” for EITC, dependency exemption and head-of-household filing status purposes contribute to taxpayer lack of understanding and inconsistent treatment. At times during EITC audits, taxpayers are required to document eligibility to claim head of household filing status and meet the test for claiming dependent exemptions when neither is required to claim the EITC. Substantiation for head of household filing status requires receipts to satisfy the “maintenance of the household” test, while dependency exemption verification requires receipts to prove “support” of the child.<sup>88</sup> The documentation required to establish head of household eligibility is not the same as is needed to claim the dependency exemption.<sup>89</sup>

**Communication Gaps Exist Between The IRS And Low Income Taxpayers During EITC Audits**

Low income taxpayers may not understand the critical nature of verifying eligibility for the Earned Income Tax Credit, and the IRS is not sufficiently sensitive to the difficulties that these taxpayers encounter in acquiring that verification. Feedback from Local Taxpayer Advocates (LTAs) and Low Income Taxpayer Clinics provides insight into the unique problems facing low income taxpayers. The LTAs and the clinics consistently point out that the kind of documentation that the IRS requests does not adequately consider the reality of how the low income population lives. For example:

- ◆ The residency rule requires taxpayers to verify that the child lived with them for at least six months. This is particularly difficult for taxpayers residing with children younger than five years old, who do not attend school.
- ◆ A taxpayer may not be able to get the residency information because the family moves several times in the year, the children are cared for by family members, or the family does not have a regular doctor.
- ◆ A taxpayer may not be able to substantiate head of household filing status and dependency exemption eligibility because he or she has no bank account, must

<sup>88</sup> IRC §2(b)(1) (A); §152(a).

<sup>89</sup> IRS Publication 17: *Your Federal Income Tax For Individuals*, TAX GUIDE 2001 pages 24 and 29.

deal in cash or money orders, does not keep receipts or does not understand what is required. It is unlikely a landlord has listed children's names on the lease, unless the lease is issued under a government housing program.

- ◆ In large cities such as New York, where several hundred thousand EITC claimants reside, the working poor live in “rented rooms” or partitioned space within apartments leased to other parties. This often means individuals do not have written leases to help establish head of household status or residency requirements for EITC, nor do they have adequate receipt records since they pay rent in cash or money orders. When dependent claims are disallowed because the head of household filing status has been disallowed (e.g. where another person living at the same address claimed head of household filing status), the taxpayers are left with the difficult task of furnishing the extensive documentation necessary to prove eligibility for dependency since they must disprove that anyone else in the “household” supports the children.
- ◆ Meeting the “residency” requirements for EITC presents a major challenge for many low income taxpayers. Multiple families may use the same address to claim EITC because it is the only valid mailing address in the area or because families may share apartments to conserve cash. Taxpayers may use a relative or ex-spouse's address on school records for their children to keep them from attending poorly performing school or ones with widespread gang violence. Taxpayers sometimes receive free housing and cannot easily validate residency. In each of these instances, the legitimate EITC claim may be disallowed.
- ◆ Similar issues confront families whose roots are from other cultures. Native Americans live near or on reservations that have no street names or addresses. Alaskan community elders care for children in their villages who are often not blood relatives. Immigrants from several African countries and the Hmong from Southeast Asia do not marry and divorce through the legal government system. Their marriages and divorces are agreements between their families. The IRS continues to request unrealistic, burdensome documentation requests (grocery or housing receipts when their housing is free) and does not uniformly accept documentation from tribal councils.

Clearly, the IRS needs a verification (examination) process to validate eligibility for the EITC and forms of documentation should be required, as appropriate. Nonetheless, the experience of Local Taxpayer Advocates and the Low Income Taxpayer Clinics points out the vital need to understand and meet the needs of the increasingly diverse low income taxpayer community, and for the IRS to adapt documentation requirements that assist eligible taxpayers in validating EITC claims.



**IRS COMMENTS**

We recognize that existing documentation requirements can, and often do, pose significant challenges to taxpayers. The IRS engages in an ongoing effort to educate taxpayers on the documentation requirements relating to EITC eligibility. When a taxpayer claims EITC and the return is selected for examination, it is necessary to ask for documentation to support eligibility. The purpose of the examination is to ensure that the EITC eligibility requirements are met. Both Congress and the Treasury Inspector General for Tax Administration (TIGTA) share the concern that duplicate dependent and qualifying child overclaims are resulting in a substantial loss of tax revenue each year. It is estimated that unintentional and fraudulent EITC non-compliance has increased to an estimated \$9.3 billion a year and conducting examinations not only ensures the accuracy of the individual returns involved but it helps the Service better understand the nature of the issues involved in EITC non-compliance (in fiscal year 2002 less than 400,000 of the approximate 19 million taxpayers claiming EITC were examined).

A major source of the difficulty that many taxpayers have with EITC documentation requirements is the complexity of the tax law in this area. Since the law is complex, document requests to support EITC eligibility must be based on the facts and circumstances of each case and therefore may vary between taxpayers. If standard documentation does not support the taxpayer's claim, additional or alternative documentation may be requested. Adding to the difficulty with documentation are the differing legislative and statutory definitions for qualifying child for purposes of EITC, dependency exemption and head-of-household filing status.

**IRS INITIATIVES TO RESOLVE PROBLEM**

The IRS continues to take steps to clarify and streamline documentation requirements to substantiate EITC. Actions include:

- ◆ The design and development of a decision support tool to improve the consistency and quality of EITC eligibility determinations. The On-Line Tax Advisor (OTA) provides direct access to the IRM, procedural guides, publications and examples of acceptable documentation.
- ◆ The establishment of a documentation team to review the existing documentation requirements, to recommend alternative forms of documentation that could be provided by non-traditional taxpayers, and to issue new guidelines on acceptable documentation. This team is comprised of members from the Taxpayer Advocate Service, Chief Counsel, Wage & Investment Compliance, Small Business/Self-

Employed Compliance and Appeals. The team will make preliminary recommendations by September 2003.

- ◆ Providing examiners with access to additional data available from other government sources to reduce the documentation taxpayers need to provide. For fiscal year 2003 most taxpayers will not have to provide a Social Security card or a birth certificate, since this documentation will generally be available to the Internal Revenue Service by accessing new databases.
- ◆ New outreach efforts to non-traditional communities. For example, a communication problem was identified with Native Americans. Partnering with the TE/GE Indian Tribal Government Function and a preparer, a new specialized training module (Native Americans and Earned Income Credit) is being developed that will cover acceptable alternative documentation specific to Native Americans.
- ◆ Continued participation in the annual Tax Forums to provide practitioners with information about current issues and tax law changes. During fiscal year 2002 one session was specifically designed for tax issues related to the Hispanic Community, including EITC.
- ◆ Additional letters, forms, and publications related to EITC, including documentation requirements, are currently being converted to Spanish to provide improved tools for outreach and education.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*The National Taxpayer Advocate applauds the IRS for its development and implementation of the electronic Online Tax Advisor (OTA) to assist examination employees in evaluating taxpayer information and providing consistent treatment during routine EITC audits nationwide. TAS is disappointed to learn, however, that a more robust plan to create wider IRS employee and tax practitioner access has been delayed by funding issues. We believe OTA can result in better customer service and we support the IRS in obtaining funding to fully implement this initiative.*

*We are mindful, as well, of the flexible approach to be taken when conducting EITC audits, particularly when evaluating documentation to verify EITC eligibility. We encourage the IRS to recognize the non-traditional living arrangements often present in the low income population and work with taxpayers to find common ground when arriving at a correct audit result. It is unlikely, too, that the varied living arrangements of the target population can be programmed into an electronic assistant to produce a fair and accurate determination of eligibility. Therefore, the IRS should seek to train employees to take a common sense approach when applying the intent of the law and to make eligibility decisions accordingly. Whether in the pre-filing environment, during return processing or in post fil-*



ing compliance, IRS employees must be sensitive to issues concerning low income taxpayers, such as special language and cultural differences that may impact taxpayer communication and access to customer service.

We recognize that the IRS makes efforts to accept alternative documentation when the initial response does not completely support the taxpayer's claim. However, the IRS should, during contacts, also focus on educating low income taxpayers and their representatives. Taxpayers often obtain completely different (favorable) results from the original IRS determination when they receive assistance from TAS in EITC audit reconsiderations, EITC math error notices, and Revenue Protection Strategy examinations.<sup>90</sup> TAS intervention often involves helping the taxpayer understand what documentation is needed and then working with the taxpayer to find alternative ways of substantiating an EITC claim. TAS establishes reasonable timeframes for taxpayers to produce documentation, based on the taxpayer's specific ability and circumstances. TAS follows up with taxpayers when they miss the agreed upon timeframes. Experience has shown that many eligible taxpayers may not understand what the process requires of them in terms of "legal sufficiency" or how to find assistance. This leads to unintentional non-compliance.

An initiative aimed at addressing EITC documentation, with TAS as well as IRS servicewide participation, is an important new development in the effort to reduce taxpayer burden and clarify documentation requirements. We support the team's attempts to develop pro-forma third party verification for taxpayer use in meeting EITC, dependency and filing status tests. This proactive approach to documentation can alleviate, for example, the confusion over school term (five-month) attendance records in establishing residency of a qualifying child.

The IRS has set up several task forces and working groups, with participation by TAS and IRS Operations, in a concerted effort to improve administration of the complex EITC laws. It is just such collaborative efforts that yielded an implemented taxpayer burden reduction plan for 2003 – a method of securing birth certificate and social security information internally rather than seeking copies of this information from the taxpayer.

<sup>90</sup> For the fiscal year ending September 30, 2002, TAS closed 26,639 Wage and investment cases involving Revenue Protection Strategy cases, 2,184 cases involving math error EITC issues, and 5,532 audit reconsideration cases. TAS assistance resulted in a respective change rate of 50 percent, 60 percent, and 51 percent.



**PROBLEM  
TOPIC #7****PROCEDURES FOR EXAMINING EITC CLAIMS CAUSE HARDSHIP AND INFRINGE ON  
APPEAL RIGHTS****IRS RESPONSIBLE OFFICIALS**

John Dalrymple - Commissioner, Wage and Investment Division

Joe Kehoe - Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

The IRS process of examining or auditing Earned Income Tax Credit claims was identified as a significant problem for taxpayers in the National Taxpayer Advocate's FY 2001 Annual Report to Congress.<sup>91</sup> Despite IRS attempts to make the process less burdensome, problems persisted into 2002. Procedures established at IRS campuses (formerly service centers) for examining EITC returns create a particular set of problems for low income taxpayers. Specifically:

- ◆ IRS Revenue Protection Strategy (RPS):
  - ◆ To prevent questionable refunds, the taxpayer's entire refund is held until the examination is complete, including any refund associated with overpaid tax withholding credits. The examination process is a lengthy one and can create a hardship for qualified and needy EITC claimants.<sup>92</sup> Consequently, taxpayers justifiably seek expedited treatment of their refund claims or believe they are entitled to an immediate release of the undisputed portion of their tax refund to defray basic living expenses.
- ◆ Letter 566B and the Batch Processing of EITC audits:
  - ◆ The initial notice, Letter 566B, requesting documentation to support the EITC claim and containing the report of examination changes, includes notification of the right to appeal. Combining these two aspects of the process in one letter (the so-called "Combo" letter) means that the timeframe for the taxpayer to gather verification before receiving a statutory notice of deficiency is significantly compressed. The taxpayer may be confused as to whom to respond and thus lose the opportunity for an Appeals hearing.
  - ◆ If a taxpayer does not respond to the request for substantiation, the batch processing audit system automatically sends out a deficiency notice. A notice will also be sent if a taxpayer replies but the IRS does not associate or consider the response in the timeframe allotted.<sup>93</sup>

<sup>91</sup> National Taxpayer Advocate, *FY 2001 Annual Report to Congress*, publication 2104 (Revision 12-2001) pages 26-29.

<sup>92</sup> The average cycle time for EITC audits for FY 2001 (cumulative through July 2002) was 265 days. IRS Wage & Investment, Tax Reporting Compliance, "Exam Measure, July '02", Executive Advisory Council meeting September 2002.

<sup>93</sup> Through July of fiscal year 2001, the IRS reported closing 32,755 EITC cases that were more than one year old retaining an inventory of 24,797 open EITC cases in excess of one year. Wage and Investment, Tax Reporting Compliance, "Exam Measures July 02," Executive Advisory Council Meeting, September 2002.



- ◆ Appeal Rights:
  - ◆ Correspondence concerning appeal rights for the EITC taxpayer is unclear or non-existent. IRS correspondence consists of a computer-generated letter (75 or 75A) informing the taxpayer of a possible examination. If selected for examination, taxpayers are then sent a Letter 566B, which informs taxpayers of their appeal rights. The accompanying Publication 3498 provides guidance on how to appeal. Neither the letter nor the publication adequately covers the specific steps necessary to request an appeal, nor do they clearly state that the time frame for requesting an appeal has begun.
- ◆ Notice of Deficiency Procedures:
  - ◆ The Internal Revenue Manual (IRM) limits examiners' administrative ability to help taxpayers reach the proper decision on an eligibility determination once the notice of deficiency is issued.<sup>94</sup> Taxpayers whose substantiation may contain a minor defect are frustrated by the need to file a petition with the Tax Court; or worse, they are forced to abandon a valid claim as an outcome of the process.

#### ANALYSIS OF PROBLEM

##### Revenue Protection Strategy (RPS)

The EITC is a refundable tax credit, which means qualifying taxpayers may receive a refund greater than the amount of tax paid into the system during the tax year. However, it is difficult to collect the EITC paid to a taxpayer who is not entitled to the credit. To guarantee that the government does not jeopardize this revenue, the Campus Examination unit in 1997 began working the Revenue Protection Strategy (RPS).<sup>95</sup> This program holds part or all of the refund from a taxpayer's current year Form 1040.<sup>96</sup> There are eight main examination streams in the RPS: Earned Income Tax Credit, Exemptions, Filing Status, Schedule C Gross Receipts, Child Tax Credit, Child Care Credit, Education Credit and Adoption Credit.

The IRS holds the entire refund (Earned Income Tax Credit as well as the withholding) when a return is selected for examination under RPS. The ensuing examination process is lengthy. The average cycle time for an EITC examination in fiscal year 2001 (cumulative through July 2002) was 265 days.<sup>97</sup> An analysis of EITC examination cases from tax year 1998 disclosed that 66 percent of the taxpayers ultimately received refunds, which aver-

<sup>94</sup> Internal Revenue Manual (IRM) 4.19.1.8(3) and 4.19.1.5.1.3.6. (Rev. 10-01-2002).

<sup>95</sup> IRM 4.19.1.5.1, Service Center Examination Operations.

<sup>96</sup> IRM 25.12.1.5, Delinquent Return Refund Hold Program, Revenue Protection Strategy (Rev. 01-01-2002).

<sup>97</sup> IRS Wage & Investment, Tax Reporting Compliance, "Exam Measures July 02", Executive Advisory Council Meeting, September 2002.

aged \$1,420.<sup>98</sup> Holding entire refunds for this length of time inevitably creates hardships for low income taxpayers.

#### “Batch Processing” System

Campus Examination EITC cases are processed through the IRS Report Generating Software System (RGS), which creates numerous reports to assist tax examiners and managers in monitoring individual tax examiner inventories.<sup>99</sup> Beginning in processing year 2001, in order to maximize resources, a new batch processing system was added to existing software. The process computes tax and automatically generates Letters 566B (the “Combo” letter) with attachments and statutory notices of deficiency at predetermined timeframes.<sup>100</sup> If the taxpayer does not respond to the correspondence, or the IRS does not associate the taxpayer’s response with the case soon enough, the examination will systematically move through the audit process to closing.<sup>101</sup> The untimely handling of responses has resulted in premature notices of deficiency. During fiscal year 2001, the Taxpayer Advocate Service received over 40,000 taxpayer requests for assistance on EITC RPS cases examined by Campus Exam, many of which arose from unexplained notices of deficiency.<sup>102</sup>

#### “Combo” Letter

Before processing year 1998 for EITC examinations, and in some other correspondence examination procedures, an initial contact letter (Letter 556) informed the taxpayer of an examination and requested information to verify items in question. A subsequent letter (Letter 525, referred to as a “30 day” letter), together with an Examination Report (Form 4549), was prepared to reflect the proposed changes and the difference in the proposed refund. Another request for information was included in the event the taxpayer disagreed with the assessment. The process allowed the taxpayer approximately 60 days to compile and provide the necessary information. If the taxpayer sent incomplete documentation, the IRS sent another letter (Letter 692) requesting additional verification within 15 days.<sup>103</sup>

Beginning with processing year 1998, in an effort to reduce the length of examinations of EITC, and certain other correspondence examination issues, the IRS combined the initial

<sup>98</sup> Tax year 1998, Compliance Research Information System (CRIS), Model IFM 2002.

<sup>99</sup> IRM 4.19.1.4.10 (5).

<sup>100</sup> Letter 566B attachments include Form 4549 (Exam Report), Form 886 (list of acceptable documentation), and Publication 3498 (The Examination Process).

<sup>101</sup> IRM 4.19.1.4.10, Service Center Examination Operations.

<sup>102</sup> This volume includes cases caused because the taxpayer is suffering an economic hardship. However, economic hardship cases traditionally represent less than 15 percent of TAS case receipts. The remaining 85 percent are due to delays and system failures (systemic hardship). TAS Inventory Study, Fiscal Year 2001 Receipts, April 17, 2002, pages 40-41.

<sup>103</sup> IRM 4.19.1.5.1.2, Figure 4.19.1-1.



contact letter and the official Examination Report into one mailing (the “Combo” letter) with a 30-day response time. If the taxpayer does not respond within that time, a statutory notice of deficiency is automatically issued. The only reference to an appeal in the “Combo” letter is the following language: *“After we review what you’ve sent us, we will contact you with the results. If you **still** disagree with our findings, you have the right to file an administrative appeal as explained in the enclosed Publication 3498, The Examination Process.”* This means that the taxpayer must, within 30 days:

- ◆ Gather and mail/fax supporting documentation to Campus Examination;
- ◆ Await a denial of EITC eligibility by Campus Examination; and
- ◆ Request an appeals conference.

Prior to sending the notice of deficiency, the IRS sends a letter (Letter 692) requesting verification within 15 days if the submitted information is incomplete.<sup>104</sup>

Taxpayers examined in the EITC process receive disparate treatment from the IRS in terms of opportunities and time to substantiate the items at issue and opportunities to request appeals hearings.

#### **Correspondence Concerning Appeal Rights Is Unclear or Non-existent**

Public Law 105-206 (Internal Revenue Service Restructuring and Reform Act of 1998) explains the appeals and collection process. It states:

“The Secretary of the Treasury or the Secretary’s Delegate shall... include with any first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals an explanation of the entire process from examination through collection with respect to such proposed deficiency, including the assistance available to the taxpayer from the National Taxpayer Advocate at various points in the process.”<sup>105</sup>

The Code of Federal Regulations outlines how the IRS will implement the law. It includes the following provision: “An oral request is sufficient to obtain Appeals consideration in all office interview or correspondence exam cases.”<sup>106</sup>

The procedures and correspondence used in Exam do not give the taxpayer an adequate opportunity to request an appeal. The following documents contribute to the lack of information of appeal rights.

<sup>104</sup> IRM 4.19.1.5.1.2, Figure 4.19.1-2.

<sup>105</sup> Internal Revenue Service Restructuring and Reform Act of 1998; Pub. L. No. 105-206, Title III, Subtitle F, §3504, 112 Stat.771. Explanation of Appeal and Collection Process.

<sup>106</sup> CFR § 601.106(1)(a)(iii)(a), The taxpayer must request Appeals consideration.

The “Combo” letter states, “After we review what you have sent us, we will contact you with the results. If you still disagree with our findings, you have the right to file an administrative appeal as explained in the enclosed Publication 3498, The Examination Process.” However, the Publication 3498 states, “...The Tax examiner will explain your appeal rights” ... “You will receive a letter (known as a 30 day letter) notifying you of your right to appeal the proposed changes within 30 days.”<sup>107</sup> (Note: For EITC examinations, the taxpayer has already received the 30-day letter as part of the “Combo” Letter (566B).) The publication also mentions, “If you want to have a conference with an appeals officer, follow the instructions in the letter you received.”<sup>108</sup>

The instructions contained in the document do not appear to fulfill the mandated explanation of the appeals process in IRC § 6212. The EITC examination process does not accomplish the intent of the law, to ensure the taxpayer is made aware of his or her appeal rights. The consolidation of batch processing and the use of the “Combo” letter have, in this respect, failed to provide adequate notice of a taxpayer’s right to appeal.

Taxpayer appeal rights are not fully described in the instructions for examiners handling the Campus Examination toll-free phone lines. The IRS developed an on-line Examination Toll-Free Telephone Procedural Guide (also known as Script), which provides examiners with probes and responses to resolve taxpayer audit issues. This guide contains no information to assist taxpayers with appeals procedure questions.

When a statutory notice of deficiency is sent, the taxpayer has 90 days to petition the United States Tax Court to re-determine the amount of tax before assessment. The taxpayer may still request an administrative appeal,<sup>109</sup> but the notice does not clearly describe that right. If a taxpayer is granted Appeals consideration, he or she may mistakenly believe it is not necessary to file a petition with the Tax Court. The average administrative appeal took 293 days in tax year 2000, far beyond the allotted 90 days to petition the Tax Court.<sup>110</sup>

### Notice of Deficiency

The current IRS Campus Examination guidelines do not allow examiners to seek additional supporting documents from taxpayers once a statutory notice of deficiency is issued. The examiner may explain why a given response was insufficient, but may not

<sup>107</sup> Publication 3498 Department of the Treasury Internal Revenue Service (Rev 7-2002) Catalog number 73074S: page 6.

<sup>108</sup> Id. page 8.

<sup>109</sup> C.F.R. § 601.106 (b) Appeals Function.

<sup>110</sup> Treasury Inspector General for Tax Administration, *Taxpayers Should be Informed of the Benefits of the Fast Track Mediation System*, March 2002 # 2002-10-070.



offer suggestions or otherwise assist the taxpayer, even when the taxpayer's documentation clearly contains a minor defect.<sup>111</sup> There is no statutory prohibition governing this practice, but rather a belief that to commence a dialogue with the taxpayer would detract from the understanding about the 90-day running period to petition the Tax Court. Given the very limited timeframes for taxpayers to respond during EITC audits and the need for assistance inherent in this population of taxpayers, critical opportunities to arrive at a proper examination result may be lost during this period. Further, if necessary, IRC § 6212(d) allows for the rescission of a notice of deficiency,<sup>112</sup> while IRC § 6212(c) allows for the issuance of a second notice of deficiency unless the taxpayer has already petitioned the Tax Court.<sup>113</sup> Current IRM procedures place unnecessary limitations on taxpayers and IRS examiners' ability to resolve EITC eligibility issues through proactive and creative means throughout the examination process.

#### IRS COMMENTS

The IRS continues to take actions to make the EITC examination process less burdensome for taxpayers. However, taxpayers continue to have concerns, generally because this process involves freezing their refunds until the determination of their EITC eligibility is completed.

Recognizing that taxpayer participation reduces the length of time needed to complete an EITC examination, which in turn reduces taxpayer burden and expedites release of allowable refunds, IRS has made several unsuccessful attempts to determine why taxpayers do not respond during the examination process. During the last two fiscal years 31 - 35 percent of taxpayers contacted did not respond to EITC examination notices and this remains both a significant factor contributing to the length of time needed to complete examinations and a burden for taxpayers expecting refunds.

However, for the taxpayers (approximately 65 percent) who do respond to examination notices, the IRS is continually searching for techniques to expedite the completion of cases. One such technique was the development of the Batch Processing System, which allows for a faster response to taxpayers' correspondence and telephone inquiries and thus reduces the length of time needed to complete the examination and release allowable refunds.

<sup>111</sup> IRM 4.19.1.4.8 (3) "Do not include copy of the Letter 566B or form 886H in Statutory Notice issuance. Although documentation can be reviewed if submitted by the taxpayer, it CANNOT be requested from the taxpayer after the Statutory Notice is issued." In addition IRM 4.19.1.5.1.3.6 states "Do not solicit additional information from the TP when the case is in 90 day status."

<sup>112</sup> IRC § 6212(d) Authority to rescind notice of deficiency with taxpayer's consent.

<sup>113</sup> IRC § 6212(c). Further deficiency restricted. (1) General rule. If the Secretary has mailed to the taxpayer a notice of deficiency as provided in subsection (a), and the taxpayer files a petition with the Tax Court within the time prescribed in section 6213(a), the secretary shall have no right to determine any additional deficiency of income tax for the same taxable year.

As the Taxpayer Advocate Service mentions, another attempt to reduce the time needed to complete an EITC examination was the introduction of the “Combo” letter. This letter combines the issuance of an initial contact letter and the preliminary Examination Report (30-day letter) into one notice (similar to the process used for Underreporter cases). Taxpayers are asked to respond to the proposed tax change within 30 days by providing additional documentation, indicating agreement or requesting an appeal. An analysis of examination correspondence in the EITC program reveals that the average response time to the “Combo letter” is 25 days, so for those taxpayers responding, this timeframe is generally adequate. When using the “Combo Letter”, the Service takes no further action on cases until mail is associated or an additional 30 days after the initial 30 days offered in the “Combo Letter” has expired in an effort to ensure that cases are not moved to the next stage of the process (issuance of a statutory notice of deficiency) prematurely. Therefore, taxpayers receiving the “Combo Letter” are given at least sixty days to respond or request an Appeals Hearing.

The IRS always strives to ensure that all procedures, correspondence, and publications used in examination processes provide taxpayers with a complete understanding of their appeal rights as well as the procedures to request an appeal. During EITC examinations, taxpayers are provided comprehensive information about their appeal rights on page 8 of the Publication 3498 (Rev. 7/2002) entitled “The Examination Process.” This publication is provided with the initial correspondence (“Combo letter”). In addition, the “Combo” letter itself is subject to ongoing simplification and improvement initiatives to enhance taxpayer understanding of the examination process. During FY 2002, the “Combo” letter was revised based on feedback from the Taxpayer Advocate Service and practitioner groups and this revised letter will be implemented in January 2003.

To further reduce taxpayer burden, toll-free telephone units have been established to provide taxpayers with another avenue for making general inquiries about the EITC examination process. Initial calls regarding the examination are answered in centralized units staffed by telephone assistants. When taxpayers participate in the examination by providing requested documentation, the case is assigned to a specific tax examiner. All subsequent correspondence will have that examiner’s telephone extension as a point of contact and all subsequent contacts and inquiries, including all questions regarding appeal rights, can be directed to the tax examiner assigned the case, who is knowledgeable about appeal rights and can assist the taxpayer in understanding the procedures to exercise these rights. Taxpayers are always encouraged to participate in the examination process and work with tax examiners to resolve their cases at the lowest level.



**IRS INITIATIVES TO RESOLVE PROBLEM**

The IRS will take the following additional actions to help reduce the taxpayer hardship incurred during an EITC examination:

- ◆ As of January 2003, a correspondence received date will be input into the Audit Information Management System (AIMS), which will freeze the taxpayer's account to prevent the premature issuance of a statutory notice of deficiency.
- ◆ As mentioned in the previous National Taxpayer Advocate's Report, the IRS continues to study the feasibility of a partial refund freeze rather than a full refund freeze. Following the review of additional data, recommendations on this issue are expected by June 2003.
- ◆ Effectively immediately, tax examiners can request additional information, offer suggestions and otherwise assist the taxpayers to resolve their case after the issuance of a statutory notice of deficiency. This new procedure is based on a revised opinion from Counsel and will be incorporated in the appropriate Internal Revenue Manuals.

**TAXPAYER ADVOCATE SERVICE COMMENTS**

*The National Taxpayer Advocate remains concerned about the burden placed on low income taxpayers when their entire refunds are held pending conclusion of EITC audits. The issue was raised in discussion of last year's Most Serious Problems Encountered by Taxpayers (Topic #6, Refund Inquires). The IRS agreed to study the issue. A TAS analysis shared with IRS Operations indicates that, on average, taxpayers are entitled to a several hundred-dollar refund of the undisputed amount (primarily tax withholding), which should not be subject to pre-refund examination. The National Taxpayer Advocate strongly recommends that the IRS task force propose the release of the undisputed portion of the taxpayer refund during return processing and direct its efforts to immediate implementation.*

*The use of batch processing in EITC cases does not address the very real concerns associated with the significant percentage of taxpayers who do not respond during an audit. We are pleased that IRS agrees that more analysis is needed to address this issue and has agreed to conduct a priority research study to address this concern. A non-responding claimant is not necessarily an ineligible claimant. A variety of reasons have been put forth as to why taxpayers do not respond in EITC examinations, including language and literacy barriers, non-receipt of notices, lack of time or resources to gather documentation, lack of telephone access, lack of representation, feelings of intimidation, and fear of government intrusion as well as ineligibility.*



*The National Taxpayer Advocate believes that the IRS should devote additional resources to taxpayer outreach concerning this critical issue. During FY 1998-FY 2002, the EITC Program Office devoted a maximum of four percent funding to pre-refund initiatives, while on average 68 percent went to post-filing initiatives including Criminal Investigation, Collection, and Exam.<sup>114</sup> A further indication that more could be done to increase taxpayer participation in EITC was reported in a December 2001 General Accounting Office report, which estimated that one in four taxpayers eligible for the EITC failed to claim it.<sup>115</sup>*

*TAS remains concerned about the potential abridgement of appeal rights in EITC cases. While TAS recognizes the administrative efficiency embedded in the “Combo” letter (556B), this procedure treats low income taxpayers differently from other taxpayers who are being audited. The IRS has revised Letter 566B. However, the draft of new Letter 566BZ has language almost identical to that of Letter 566B concerning the taxpayer’s right to appeal the audit report that accompanied the letter. The National Taxpayer Advocate believes that the appeal rights as mandated in RRA 98 § 3465 are not adequately described in this letter, given the target population. This letter does **not** constitute notice of appeal rights to its intended recipients. The publication informs the taxpayer of appeal rights as mandated in the law, but inadequately explains the procedure to this unsophisticated, often unrepresented population. The efficiencies of the “Combo” letters do not offset the fact that low income taxpayers are not receiving separate, clear notice of their appeal rights. The use of the “Combo” letter should be discontinued, and Publication 3498 should be rewritten to more clearly describe the appeals process.*

*The long-established policy of prohibiting the tax examiners from requesting information after the issuance of the Notice of Deficiency meant a lost opportunity for IRS to take steps to resolve audit issues. This policy especially affected EITC claimants whose examination process is so telescoped. The recent action by the IRS, prompted by a collaborate effort of TAS and IRS, resulted in the discontinuation of this practice. With Chief Counsel approval the IRS issued a National Alert on November 25, 2002<sup>116</sup> to tax examiners to continue to work with the taxpayer to resolve the tax matter after the issuance of the Notice of Deficiency, provided the taxpayer is notified that the time for filing a petition continues to run. TAS believes this policy change will enable taxpayers and the IRS to communicate more effectively, reduce taxpayer burden and correctly resolve more EITC audits.*

<sup>114</sup> *Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 1998-FY 2002*: Appendix A, Department of the Treasury, Internal Revenue Service, February 28, 2002.

<sup>115</sup> U.S. General Accounting Office, *Earned Income Tax Credit Participation*, GAO -02-290R December 14, 2001.

<sup>116</sup> IRM Procedural Update; Number W 03090; “Taxpayer Replies to 90 Day Letter”.



## PROBLEM

### TOPIC #8

### LACK OF RESPONSE DURING EITC EXAMS

#### IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage and Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

#### DEFINITION OF PROBLEM

The lack of personal contact with an IRS examiner during an EITC examination imposes an unnecessary burden on EITC filers and leaves some taxpayers unsure of the status of their cases. Taxpayers continue to report frustration in getting through by telephone to the IRS specialists listed on the notices they receive, and employees fail to return calls from taxpayers, their representatives and Taxpayer Advocate Service (TAS) case advocates.<sup>117</sup> Remote Examination employees do not use the telephone as a primary means of communication with customers, even when a phone call could answer audit status questions and resolve cases instead of letting them progress to a statutory notice of deficiency.

#### ANALYSIS OF PROBLEM

Before 1998, the IRS campuses' (formerly service centers) Remote Examination functions were called "Correspondence Audit." In May 1998, as part of its efforts to improve customer service, the IRS moved to establish a toll-free telephone system in Remote Examination. This system was implemented nationwide in November 2000. Taxpayers selected for examination are given a toll free number to call if they have questions about the documentation requested by mail to support items claimed on their returns, or about the status of their cases.

It has been a challenge for Campus Remote Exam employees to use the telephone effectively in examinations. The toll-free operation has required changes in examination processes and the examiners' approach. Correspondence had long been the preferred and often the only means of communication.<sup>118</sup> The toll-free phone number is now listed on all letters, beginning with the initial contact letter, which notifies the taxpayer of the pending exam.<sup>119</sup> All EITC filers selected for audit by Remote Examination are provided a toll free number to call about the documentation requested or the status of their case.<sup>120</sup> However, taxpayers, low income taxpayer clinic representatives and IRS employees have indicated that this number is answered by voice mail. One clinic reported that it has never received a response to any message left on the voice mail.<sup>121</sup>

<sup>117</sup> IRS Customer Satisfaction Survey, Service Center Examination, March 2001.

<sup>118</sup> IRS Commissioner, Wage and Investment Division, Memorandum for Treasury Inspector General for Tax Administration, Response to Audit Report #200140041, Implementation of the Remote Examination Toll-Free Telephone Program is Ongoing, December 7, 2001.

<sup>119</sup> Letter 566-B (SC/CG) (Rev. 11-2000).

<sup>120</sup> Id.

<sup>121</sup> Legal Aid Society of Minneapolis, Comments to a Local Taxpayer Advocate, June 2002.

Additionally, a recent revision to the Internal Revenue Manual (IRM) requires examiners to attempt telephone calls three times before sending a letter requesting additional information.<sup>122</sup> However, examinations are still completed without such contact, and some cases that could have been resolved by telephone instead progress to the issuance of a statutory notice of deficiency. At that point, the taxpayer has 90 days to file a petition in the United States Tax Court.

This lack of communication leads to unnecessary frustration on the part of taxpayers and adds a significant expense to taxpayers who are least able to afford it. One Low Income Taxpayer Clinic reported to the National Taxpayer Advocate that 80 percent of the EITC taxpayers it represented before the Tax Court had their deficiencies reduced or abated.<sup>123</sup> A recent review of EITC-related docketed appeals cases bears out the clinic's experience.<sup>124</sup>

Some taxpayers' documentation is submitted several times and is never associated with the audit file. Many cases are closed and the EITC denied without the taxpayer ever knowing whether the IRS received or considered the documentation. In audit reconsideration cases, taxpayers and practitioners have presented certified mail receipts to the Taxpayer Advocate Service to substantiate that information was sent to the IRS timely yet not acted upon.

#### IRS COMMENTS

While the remote/correspondence exam process is not premised on telephone contact during examination, the IRS is concerned with the current level of access when taxpayers do try to reach us by telephone related to their EITC examinations.

In an effort to improve customer service to taxpayers, the IRS established a toll-free telephone system in remote Examination operations on the campuses during fiscal year 2000. Initial contact letters sent to taxpayers provide toll-free numbers for the taxpayers to call with general inquiries. These calls are answered in centralized phone units, which are staffed by telephone assistants. While waiting to reach a live assistant, the taxpayers can listen to pre-recorded messages that may answer their question or wait to speak to the assistant. However, in fiscal year 2002 the number of calls received at these phone units increased at a pace that could not be matched with available resources, making it very difficult for IRS to be responsive to taxpayers at the desired level.

<sup>122</sup> Internal Revenue Manual (IRM), Service Center Examinations Operations, § 4.19.1.4.6.

<sup>123</sup> Georgia State University, College of Law Tax Clinic reported that of the 25 taxpayers that they represented in cases before the United States Tax Court during the May 2002 trial calendar, 15 had their entire proposed deficiency abated and five taxpayers had the deficiency substantially abated.

<sup>124</sup> The August 2002 Appeals Office review, completed at the request of the Taxpayer Advocate Service, shows that in a sample of 125 docketed EITC cases, 85.6 percent received government concession. Of those, 58.4 percent received full concession, and 27.2 percent received partial concession.



Taxpayers may experience telephone access issues not only when contacting the centralized phone units discussed above but also when taxpayers are trying to reach the tax examiner assigned to their case. When taxpayers provide a response to the initial inquiry requiring further interaction, taxpayers are given the telephone number of the tax examiner handling their case; however, based on workload levels, taxpayers may not always be able to easily reach that tax examiner.

The IRS believes that additional resources are needed to effectively handle the volume of calls regarding EITC examinations. However, in an effort to maximize the efficiency of current telephone operations, new initiatives such as the implementation of an Inventory Management Tool, which enables management to more consistently match available resources with projected telephone demand will continue.

#### IRS INITIATIVES TO RESOLVE PROBLEM

Improving taxpayers' access during the remote examination process became one of our top priorities in fiscal year 2002 and the following actions are being taken to support this goal:

- ◆ A new IRM section, (IRM 4.19.18(4)), requiring tax examiners to respond to all taxpayer calls within three business days will be implemented in November 2002,
- ◆ Fax machines have been placed in all remote examination units so taxpayers can forward documentation directly to the tax examiner assigned to their case which may reduce the need to contact the tax examiner by telephone to provide further clarification.
- ◆ An Inventory Management Tool has been implemented that enables managers to better forecast the resource demands associated with projected telephone demands. Use of this tool should improve taxpayers' ability to reach an examiner by telephone.
- ◆ A new Correspondence Examination Automation Support (CEAS) system is currently being developed. In fiscal year 2003, CEAS will provide telephone assistants in the centralized units with universal access to case information and providing this information may reduce the number of taxpayer callbacks and requests for information needed.

**TAXPAYER ADVOCATE SERVICE COMMENTS**

*The National Taxpayer Advocate appreciates IRS efforts to improve customer service by establishing a toll-free telephone system in Remote Examination and committing to increase funding for improvements in telephone service in FY 2003. We can appreciate the difficulty the IRS faces in handling the substantial increase in demand for Remote Examination toll-free service, as well as the IRS' concern about the impact on taxpayer level of access.*

*TAS agrees that the deployment of toll-free telephone assistors, rather than auditors, to answer general inquiries from initial contact letters is a better use of Campus Remote Examination resources. Equipped with the W&I Examination Toll-Free Telephone Procedural Guide, assistors can readily respond to most taxpayer inquiries. However, the responses outlined in the guide are generic. A taxpayer with specific questions about his or her case will not have these questions referred to an examiner unless a specific examiner is working the case and the taxpayer asks for that examiner's telephone extension.<sup>125</sup>*

*The case is not assigned to an examiner until the taxpayer sends in correspondence and the correspondence is associated with the case. We suggest that the IRS take telephone numbers from taxpayers at any point in the process when they wish to be contacted by the examiner. This will help facilitate communication during the examination process.*

*We are concerned that Remote Examination sites comply with the mandate of the IRS Restructuring and Reform Act of 1998 (RRA98) relating to assignment of audits. The use of telephone assistors to handle taxpayer telephone calls does not fulfill the assurance given by W&I to the Treasury Inspector General for Tax Administration (TIGTA) to provide taxpayers with a single point of contact throughout the examination process. We concur with the TIGTA suggestion that reviewing telephone activity reports in conjunction with local Quality Review staff assessments may help ensure compliance with RRA98.<sup>126</sup>*

*We strongly support the IRS' continued emphasis on the requirement to call the taxpayer before sending a letter requesting additional information.<sup>127</sup> Furthermore, the Taxpayer Advocate Service has elevated the recommendation that more emphasis be placed on contacting third parties to validate EITC*

<sup>125</sup> IRS, *W & I Examination Toll-Free Telephone Procedural Guide*. "Note: No calls are to be transferred to a tax examiner, unless a taxpayer who has inadvertently been routed through to the phone units asks to be transferred to a specific extension."

<sup>126</sup> IRS Commissioner, Wage & Investment Division, Memorandum for Treasury Inspector General for Tax Administration; Response to Audit Report #2002-40-034 Recommendation 1, "The Commission W & I Division, should ensure that Remote Examination sites comply with RRA 98 mandates relating to the assignment of Audits and the inclusion of specific information on IRS audit correspondence." Implementation of the Remote Exam Toll-Free Telephone Program is Ongoing, December 7, 2001.

<sup>127</sup> IRS Commissioner, Wage & Investment Division, Memorandum for Treasury Inspector General for Tax Administration; Response to Audit Report #2002-40-034 Recommendation 2, "The Commissioner, W & I Division, should ensure that auditors attempt telephone contact with the taxpayers who provide the IRS with a telephone number when additional information is needed." *Implementation of the Remote Exam Toll-Free Telephone Program is Ongoing* (December 7, 2001).



*claims. In most instances, examination employees opt not to contact third parties because of the administrative procedures required in these contacts. RRA98 Section 3417 enacted IRC §7602(c)(1), which prohibits IRS employees from contacting persons other than the taxpayer to obtain information relating to a determination of tax without prior notification to the taxpayer and without following certain other administrative requirements.<sup>128</sup> The Taxpayer Advocate Service looks forward to IRS support for increased use of third party contacts in eligibility determinations.*

*We are pleased with ongoing initiatives to improve taxpayer access to Remote Examination. The proactive policy of requiring examiners to respond to all calls within three business days is significant. Placing facsimile machines in all units to receive documentation directly from taxpayers should greatly reduce instances of unassociated taxpayer documentation. We look forward to further improvements that the Inventory Management Tool and Correspondence Examination Automation Support will engender. The Taxpayer Advocate Service will continue to follow these initiatives in FY 2003.*

<sup>128</sup> In addition to notifying taxpayers that they will be contacting a third party, Service employees must maintain records of third parties contacted and send the taxpayer a list of those third parties both periodically and at the taxpayer's request.

## PROBLEM

## TOPIC #9

## IRS OVERSIGHT OF EITC RETURN PREPARERS CAN BE IMPROVED

## IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

David B. Palmer – Chief, Criminal Investigation

## DEFINITION OF PROBLEM

The laws and regulations governing family status in the Internal Revenue Code are numerous and complex. As a result, taxpayers must often seek the service of paid tax preparers to claim credits and benefits on returns. Low income taxpayers are particularly susceptible to this need. They rely extensively on paid preparers to assist in navigating the intricacies of the Earned Income Tax Credit (EITC).<sup>129</sup> Paradoxically, the very practitioners that taxpayers depend on for help account for one third of EITC related mathematical errors on tax returns.<sup>130</sup> Further, of the approximately 161,000 returns selected for EITC examination in 2002, through mid-October nearly 67 percent (108,000) were preparer-filed returns.<sup>131</sup> Tax returns selected for examination represent returns that the IRS believes have a high probability of error.

EITC filing errors caused by tax law complexity may be unintentional, or result from inadvertent misinformation supplied by taxpayers. The lucrative nature of the tax preparation business and the vulnerability of needy EITC claimants leave the field open for casual, if not unscrupulous preparers.<sup>132</sup>

IRS statistics show that for tax year 1999, paid preparer returns accounted for 33 percent of math errors related to EITC. While it is unknown whether the tax preparer or the taxpayer provided the incorrect information, this error rate clearly demonstrates there are a number of problems associated with professionally prepared returns.

<sup>129</sup> For tax year 2000, 46 percent of W&I low income filers and 65 percent of EITC claimants used a paid preparer. (IRS Wage and Investment, “Tax Year 2000 Return Information (Nationwide).”)

<sup>130</sup> For tax year 1999, self-prepared returns generated 616,929 math errors, paid preparers other than H & R Block offices generated 302,642 and H & R Block returns generated 10,675 math errors. The IRS, Volunteer Income Tax Assistor and Tax Counseling for the Elderly preparer groups assisted with returns that generated 9,993 of the over 900,000 math errors identified on TY 1999 returns. Tax year 1999, Compliance Research Information System (CRIS), Model IFM 2001.

<sup>131</sup> IRS Wage and Investment Office of Research, “Measuring Effectiveness of EITC Dependent Database – PY 2002 (Project #3-02-12-3-004/CR-33A)”, Interim Report #2 (November 2002).

<sup>132</sup> Forty percent of taxpayers who get Refund Anticipation Loans (short term loans by commercial tax preparers and the banks that provide the loans secured by the taxpayers’ tax refund) are EITC recipients. Tax refund loan costs siphon off an estimated \$324 million in loan fees and cost an additional \$670 million in tax preparation, electronic filing fees, and check cashing fees every year from the Earned Income Tax Credit. Consumer Federation of America and the National Consumer Law Center Inc., “Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed From The Working Poor and The U. S. Treasury,” January 31, 2002, available at [www.consumerlaw.org](http://www.consumerlaw.org) - Special Reports, October 2002.



**ANALYSIS OF PROBLEM**

During processing year 2000, paid preparers filed 44 percent of paper returns and 82 percent of electronic returns claiming EITC.<sup>133</sup> Each year, the Internal Revenue Service reports the top ten mathematical and clerical errors on returns submitted by paid preparers. Earned Income Tax Credit related errors appeared among the top errors on Forms 1040, 1040A and 1040EZ paper returns in processing year 2002 (through July 26, 2002), the primary error being the “Earned income credit was figured or entered incorrectly.”<sup>134</sup> In addition, the IRS selects returns for examination based on the high probability of those returns containing unallowable or misreported items. A recent interim report compiled by the IRS Office of Research determined that during processing year 2002, 66.9 percent of the returns selected for EITC examination, based on pre-determined probability rules, were completed by paid preparers.<sup>135</sup>

Simplifying the complex family status provisions of the Code could reduce errors, as proposed by the National Taxpayer Advocate in her fiscal year 2001 Annual Report to Congress.<sup>136</sup> However, given the error rates of EITC returns prepared by paid preparers, more immediate measures are needed.

Four types of individuals prepare returns professionally:

- ◆ Attorneys – An attorney is licensed and regulated by state agencies and is generally required to maintain his or her knowledge base through continuing education. Attorneys often prepare taxes for clients in connection with other legal matters, for example, business and estate planning. Attorneys are authorized to represent taxpayers in practice before the IRS.
- ◆ Certified Public Accountants (CPAs) - A CPA is licensed by a state agency and is required to maintain his or her knowledge base through continuing education. CPAs can often provide useful financial planning advice in addition to tax preparation. CPAs are authorized to represent taxpayers in practice before the IRS.
- ◆ Enrolled Agents (EAs) - Enrolled agents are certified by the IRS; many are former employees of the agency. They are also authorized to represent taxpayers in prac-

<sup>133</sup> Paid preparers filed 12.1 million of the 18.5 million EITC returns processed during 2000. IRS Wage and Investment Division, “TY 2000 Return Information (Nationwide).”

<sup>134</sup> Internal Revenue Service, The Digital Daily – Tax Professionals, *Top Errors for Paid Preparers on Paper Return Submissions* (Through July 26, 2002), available at [www.irs.gov](http://www.irs.gov).

<sup>135</sup> The IRS Dependent Database process adds external data from the Department of Health and Human Services and Social Security Administration to internal and applies a comprehensive set of rules to score returns for audit selection. IRS Wage and Investment Office of Research, *Measuring Effectiveness of EITC Dependent Database – PY 2002* (Project #3-02-12-3-004/CR-33A), Interim Report #2 (November 2002).

<sup>136</sup> National Taxpayer Advocate, *FY 2001 Annual Report to Congress*, Publication 2104 (Revision 12-2001), Pages 76-127.



tice before the IRS. Enrolled agents also have to maintain continuing education requirements.<sup>137</sup>

- ◆ Unenrolled Return Preparers- This category consists of many different types of preparers, from financial planners and retired accountants to part-time preparers operating out of check-cashing businesses. An unenrolled return preparer is not authorized to represent taxpayers before the IRS, except with regard to an examination of a return prepared by that preparer. They have no federal licensing or education requirements.

“Tax preparers may range from certified experts with credentials who are knowledgeable in new tax changes through continued education to an unlicensed, unqualified person with a pencil and a calculator trying to make a little extra money to pay off holiday debts.”<sup>138</sup>

It is this last group of tax preparers that causes concern to tax administrators and low income advocates alike. If an EITC refund is denied because of a preparer’s error, the low income taxpayer faces substantial hardship. Until the IRS is able to regulate this group of preparers, other means of preventing errors on EITC returns must be explored, either by educating practitioners directly or through increased partnering with outside organizations that provide return preparation training.

Some tax preparers intentionally disregard the tax laws, or fail to solicit the correct information from the taxpayer, to obtain erroneous refunds and larger service fees. While there are many reputable tax professionals that assist their clients with return preparation, there are also those who provide less than accurate information, causing clients’ refunds to be “frozen” and their claims disallowed.

The IRS reported that during the past three fiscal years, the Return Preparer Program initiated 96 criminal investigations involving return preparer schemes relating to fraudulent EITC claims. These investigations identified a minimum of 6,854 questionable returns claiming over \$18 million dollars in unsubstantiated EITC. The IRS Questionable Refund Program netted 176 investigations involving over 7,000 questionable returns claiming over \$17 million dollars in fraudulent EITC.<sup>139</sup> These efforts are commendable and we encourage the IRS to continue on this course.

<sup>137</sup> In order to qualify for enrollment to practice before the Internal Revenue Service, an individual must demonstrate competence in tax matters by written examination in addition to other requirements. Effective after March 31, 2004, an individual must certify on an application for renewal of enrollment that he/she has satisfied specified continuing professional education requirements. For example, a minimum of 16 hours of continuing education credit must be completed during each calendar year in the enrollment term. Source: Department of the Treasury, Treasury Department Circular No. 230, “Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service – Title 31 Code of Federal Regulations, Subtitle A, Part 10, Subpart A—*Rules Governing Authority to Practice* (July 26, 2002).

<sup>138</sup> *Learn About Taxes: Choosing the Right Tax Preparer*, available at <http://www.taxgaga.com>, October 21, 2002.

<sup>139</sup> Department of the Treasury, Internal Revenue Service, *Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 1998 – FY 2002* (February 28, 2002).



To facilitate accurate EITC claims, Congress enacted Internal Revenue Code section 6695(g).<sup>140</sup> This provision authorizes the IRS to impose a penalty on preparers for failing to exercise due diligence in determining clients' eligibility for the EITC and the amount of the credit. Any person who prepares a return or claim for refund for compensation or employs other persons to prepare returns or claims is considered an income tax return preparer.<sup>141</sup> The preparer must complete Form 8867, Paid Preparer's Earned Income Credit Checklist, or otherwise record the answers to the questions it contains, and retain the form (or substitute) and the appropriate worksheets in his or her records for three years. Failure to meet the due diligence requirements could result in a \$100 penalty for each failure under IRC § 6695(g). This penalty could deter fraudulent EITC returns; however, only 101 penalties were assessed during fiscal year 2001.<sup>142</sup> The IRS can place more emphasis on enforcing the requirements of IRC § 6695(g).

While the taxpayer is ultimately responsible for the information on his or her return, the tax preparer is also responsible for showing diligence in preparing the return.<sup>143</sup> The IRS must take the lead in assuring that paid preparers are adequately trained and updated on tax law changes and that unscrupulous preparers are not allowed to continue their unethical, illegal practices. To meet this challenge, the IRS must seek to educate the preparer community by, for example, conducting ongoing outreach. It must guard against the fraudulent claims of those taxpayers and return preparers who seek to use the system for personal gain. Establishing standards and procedures for registering and certifying tax preparers under IRS guidelines may be one way to reduce fraudulent claims and produce a higher percentage of error free tax returns.

#### IRS COMMENTS

The IRS agrees that IRS oversight of EITC return preparers can be improved. We also believe that this issue is equally important for non-EITC returns and return preparation.

To meet the challenge of providing improved oversight, the IRS must continue a balanced strategy of providing education to the preparer community through ongoing outreach and guarding against the fraudulent claims of those return preparers who seek to use the system for personal gain through preparer investigations and sanctions. We also believe that

<sup>140</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, Section 1085(a)(2).

<sup>141</sup> Internal Revenue Manual 4.19.1, Service Center (Campus) Examination Operations, *Return Preparer Penalties*, Page 13 (Rev. October 1, 2001).

<sup>142</sup> Commissioner, Wage and Investment Division, Earned Income Tax Credit Program Office, *IRS Tracking – Earned Income Tax Credit Appropriation, Fourth Quarter – FY 2001*.

<sup>143</sup> Treasury Department Circular No. 230 (Rev. 7-94) *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service*, §10.22 Diligence as to accuracy.

establishing standards and procedures for registering and certifying all tax preparers under IRS guidelines would provide a new and effective tool by reducing fraudulent claims, producing a higher percentage of error free tax returns, and advancing the cause of providing better tax services to the public.

While the taxpayer is ultimately responsible for the information on his or her return, tax preparers are also responsible for showing diligence in preparing returns and it is clear the IRS has an oversight role in the exercise of this diligence.

#### IRS INITIATIVES TO RESOLVE PROBLEM

To the extent resources allow, the IRS will increase enforcement actions against those return preparers who are identified as consistently submitting erroneous and/or fraudulent returns.

The IRS intends to issue an advance notice of proposed rulemaking shortly that will request public comments regarding a proposal that would require registration and certification for all tax preparers.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*The Taxpayer Advocate Service believes that tax return preparers who operate in low income communities and handle EITC returns require a heightened level of monitoring and regulation. Generally, non-EITC refunds are made up of income tax withholding paid through income withholding, whereas the EITC refund is a refundable credit paid with public funds. In 2001, the federal EITC provided over \$30 billion to 18.5 million low-income taxpayers. Low income taxpayers provide a source of significant revenue for legitimate and unscrupulous preparers alike. Many members of the low income community must compensate for a lack of education, language barriers, fear or intimidation, and have little in the way of bank accounts or cash on hand to pay for tax preparation. Studies estimate that \$994 million in EITC refunds were recycled to tax preparers and related businesses in the form of preparation, filing, loan and check cashing fees.<sup>144</sup> The IRS must undertake a significant consumer education campaign so that low income taxpayers are able to make informed choices between tax preparers and tax preparation products.*

*The IRS' efforts to increase outreach to the practitioner community through field visits and other contacts are commendable and the National Taxpayer Advocate supports increased activity in this area. The IRS recognizes the need to increase enforcement of current due diligence requirements by imposing monetary penalties on preparers that make multiple false claims for EITC and seeking criminal sanctions when appropriate.*

<sup>144</sup> Consumer Federation of America and the National Consumer Law Center Inc., "Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed From The Working Poor and The U. S. Treasury," January 31, 2002 at [www.consumerlaw.org](http://www.consumerlaw.org) - Special Reports (October 2002).



*The results of a recent Gallup survey indicate that the outreach visits could be refocused, however. The survey analysis concluded that, “The lower the education level of the tax preparer, the more useful he or she found the IRS EITC visit to be.”<sup>145</sup> Undeniably, the ever-increasing use of paid tax preparers for EITC filers means the IRS needs to become ever more involved in the education and oversight of tax preparers.*

*The National Taxpayer Advocate commends the IRS for seeking public comments on a proposal that would establish standards and procedures to regulate and certify tax return preparers. The National Taxpayer Advocate is proposing a legislative certification scheme to address this problem. (See “Regulation of Federal Return Preparers” elsewhere in this report.) Several states have passed legislation to govern preparers of income tax returns, both state and federal. For example, California requires a \$5,000 bond be maintained by all tax preparers (definition also defined in the code section) which “shall be payable to, the people of the State of California and shall be for the benefit of any person or persons damaged by any fraud, dishonesty, misstatement, misrepresentation, deceit, or any unlawful acts or omissions by the tax preparer, or the tax preparers employed or associated with it to provide tax preparation services.”<sup>146</sup>*

*Additionally, the current EITC compliance appropriation was scheduled to expire September 30, 2002. For the IRS to continue its EITC-related strategies, Congress must appropriate necessary funds. The National Taxpayer Advocate supports a continuation of funding for these efforts, which are estimated to have saved the government five billion dollars with an appropriation of \$716 million over the past five years.*

<sup>145</sup> The Gallup Organization, *EITC Preparer Outreach Program Customer Satisfaction Questionnaire*, (March 6, 2000), Page 3.

<sup>146</sup> California Business & Professions Code Section 22250-22259, at [http://www.ctec.org/html/legislative\\_authority.html](http://www.ctec.org/html/legislative_authority.html)

## PROBLEM

## TOPIC #10

## THE LENGTH OF EITC AUDITS CONTRIBUTES TO TAXPAYER CONCERNS

## IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage and Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

## DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) correspondence audit process requires taxpayers to substantiate their eligibility for the credit they claim. As part of the process, the IRS must select, notify and further correspond with taxpayers, reviewing and analyzing the verification they provide. The various steps add time to the audit.<sup>147</sup> Of critical importance to low income taxpayers is that most EITC audits are conducted in a pre-refund environment, which involves holding the taxpayer's refund, including any income tax withholding, until the audit is finished. As a result, delays in the EITC audit process can have significant economic consequences to taxpayers. The more expeditious the process, the more quickly taxpayers can receive their refunds when warranted.<sup>148</sup>

The lack of available resources to handle the cases under audit consideration contributes to delays. For example, if their returns are not selected for audit after they are notified of a frozen refund, taxpayers are told the IRS will issue a letter in eight weeks to inform them of the refund status.<sup>149</sup> Historically, an average of only 43 percent of such refunds are issued within the stated timeframe.<sup>150</sup> Furthermore, as of July 2002, there were still more than 25,000 pieces of over-age correspondence waiting to be reviewed.<sup>151</sup>

The IRS must protect the government's revenue while ensuring that taxpayers who are eligible and entitled to refunds receive them timely. Resource limitations are preventing the IRS from meeting this goal.

<sup>147</sup> The average time to complete an EITC audit was 265 days in fiscal year 2001. Source: "Exam Measures" July 2002. IRS Wage & Investment Report, September 2002.

<sup>148</sup> An analysis of 1998 audited EITC cases showed that 66 percent ultimately received a refund. The average amount of the refund was \$1,420. Source: Tax Year 1998, Compliance Research Information System (CRIS), Model IFM 2002.

<sup>149</sup> IRS Letter 75 or 75A is issued to notify the taxpayer that his/her refund is being held and the timeframe for the next contact.

<sup>150</sup> U.S. General Accounting Office, *Earned Income Credit Opportunities To Make Recertification Program Less Confusing and More Consistent*, GAO-02-449 (Washington, D.C.: Apr. 25, 2002), page 36.

<sup>151</sup> Total over-age mail (status 57) means returns identified on the status workload review list as having correspondence over 60 days old; taxpayer has responded but case has not been worked. Source: "Exam Measures" July 02.xls. IRS W&I Director, Examination Strategy and Selection Report, September 2002.



**ANALYSIS OF PROBLEM**

The issue of lengthy EITC examinations was identified as one of the most serious problems facing taxpayers in the 2001 National Taxpayer Advocate Annual Report to Congress.<sup>152</sup>

**Procedures**

EITC cases fall under the Revenue Protection Strategy (RPS), which freezes the taxpayer's entire refund pending completion of the audit. The examination begins when cases are selected from the Electronic Fraud Detection System (EFDS) files, the dependent database (DDb), research extracts, or prior audit activity.

Prior to 1997, correspondence audits involving EITC began with an initial contact letter informing the taxpayer of an impending audit and requesting documentation to prove the item(s) claimed.<sup>153</sup> A follow-up letter was sent with an examination report and another request for information.<sup>154</sup> If the taxpayer did not respond, the case remained open for 232 days.<sup>155</sup> The audit timeframe could be shortened or lengthened according to the type of verification documents sent by the taxpayer.

To address concerns about the lengthy audit process, the IRS revised its procedures. The correspondence audits now combine the initial and follow-up letters into one, referred to as a "Combo" letter. A letter informing the taxpayer of a delay in tax refund and possible examination precedes this "Combo" letter.<sup>156</sup> The letter states, "IRS may audit your tax return for reasons relating to filing status, earned income credit or dependent(s). We will send you a letter within 30 days if we are going to examine your return before we issue your refund...if we are not going to examine your return, you will receive notification from us within eight weeks. We apologize for any inconvenience." The taxpayer is not asked to respond during this first 30 days because IRS has not yet decided whether to examine the tax return.

If the IRS decides to examine the tax return, the "Combo" letter is sent requesting documentation to verify eligibility for the EITC.<sup>157</sup> It includes a report of changes for taxpayer signature. If the taxpayer does not respond, a Statutory Notice of Deficiency is sent. The

<sup>152</sup> National Taxpayer Advocate, *FY 2001 Annual Report to Congress*; Publication 2140, (revised 12-2001), page 26.

<sup>153</sup> Letter 566.

<sup>154</sup> Letter 525.

<sup>155</sup> IRM 4.19.1, Figure 4.19.1-3, Correspondence Exam Non-EITC Timeline on Refund Returns.

<sup>156</sup> Letter 75 or Letter 75A, which relates to Recertification.

<sup>157</sup> Letter 566B, which combines the request for supporting documentation with the explanation of the proposed adjustment and appeal rights.

Statutory Notice of Deficiency explains timeframes and guidance concerning petitioning the United States Tax Court if the taxpayer does not agree with the proposed assessment.<sup>158</sup>

### Plans and Resources

Although correspondence audit timeframes have been reduced, the audit process remains a lengthy one. Based on a July 2002 statistical report, the average time to complete an EITC audit during fiscal year 2001 was 265 days. Furthermore, 33,000 cases remained open more than one year.<sup>159</sup>

The correspondence audit plan incorporates cases which are selected for examination based on prior audit activity. They include the “Pickup” cases (current year returns examined for the same issue as the prior year audit), EITC claims (1040X), audit reconsiderations and recertification cases. Although 26 percent of the plan in FY 2001 was set aside for these cases, they actually consumed 41 percent of planned cases started, thus affecting the ability to complete current workload.<sup>160</sup>

Low Income Taxpayer Clinics and Local Taxpayer Advocates report that the timeframes promised in the delay of refund letters sent to EITC claimants have not been met. As an example, a Low Income Taxpayer Clinic reported that a taxpayer received a “delay of refund” letter dated March 4, 2002, informing him that his refund was being held for 30 days pending a possible audit. The next contact was a “Combo” letter requesting documentation to substantiate the EITC claim. The letter was dated May 17, 2002, well beyond the 30-day timeframe.

Taxpayer Advocate Service cases include those requests for assistance from taxpayers because the IRS has not responded to the taxpayer within 30 days or by the promised date.<sup>161</sup> In FY 2002, EITC TAS cases numbered 40,411. Of those, 60 percent or 24,287 resulted from operational delays.<sup>162</sup> This is another indication that timeframes for EITC audits are problematic.

<sup>158</sup> IRC § 6213 (a) Time for filing petition and restriction on assessment. Within 90 days, or 150 if the notice is addressed to a person outside the United States, after the notice of deficiency, authorized in IRC § 6212 is mailed... the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency.

<sup>159</sup> Exam Measures” July02.xls. IRS Wage & Investment Director, Examination Strategy and Selection, EITC Advisory Council Meeting, September 2002.

<sup>160</sup> EITC New Starts: Plan vs Actual: Source Doc: Weekly SC Reporting DTD, as of August 4, 2001.

<sup>161</sup> IRC 7811§(a)(2)(B); (IRM 13.1.7.2 Taxpayer Advocate Case Criteria; Criteria #5 and #6.

<sup>162</sup> Commissioner’s Monthly Reports, Receipts FY 2002: TAS Office of Program Planning and Quality. EITC issues account for 18 percent of all TAS receipts. EITC receipts include major issue codes 470 (math error EITC issues), 471 (EITC/RPS Exam Projects), 472 (EITC Invalid SSN), 474 (EITC Criminal Investigation). Also included are 52 percent of major issue code 610 (Open Audits) and 38 percent of code 620 (Audit Reconsiderations). Does not include an unspecified number of EITC refund inquiry cases.



**IRS COMMENTS**

The IRS is devoting significant resources to increasing taxpayer awareness of EITC requirements, improving selection accuracy for EITC examinations and simplifying the return examination process. One of the primary purposes of the increased emphasis in these areas is to increase taxpayer participation in the examination process.

Taxpayer participation plays a key role in the length of EITC audits. During fiscal year 2002, the time required to complete an EITC examination when the taxpayer did respond was approximately 167 days for no change cases and 96 days for agreed cases. While we continually strive to reduce this timeframe, in contrast, for those cases where the taxpayers did not respond (these cases frequently later re-enter the examination process as audit reconsiderations), the time required to complete the examination increased to approximately 272 days. It is clear that taxpayer cooperation not only improves the accuracy of case resolution, but also shortens the timeframe of the examination process.

**IRS INITIATIVES TO RESOLVE PROBLEM**

The IRS continues to strive for improved efficiency in the EITC examination process, as well as increased taxpayer participation and an overall reduction in taxpayer burden. One automation initiative recently developed to improve system efficiency is the Batch Processing System, which allows for a more expeditious response to taxpayers who do participate in the examination process.

The simplification of examination notices, increased taxpayer participation in examinations, and process improvements has resulted in a reduction of the number of EITC cases that take more than 365 days to close. During fiscal year 2002, the number of EITC cases in inventory for more than 365 days was reduced by 27 percent.

Additional actions to reduce the length of EITC examinations include the following:

- ◆ Simplifying the Form 886H so that the information provided to the taxpayer directly relates to their individual issue. This change is aimed at improving the taxpayer response rate to the initial inquiry, because taxpayers will not be so overwhelmed by the amount and complexity of the information provided on the form (much of which is not applicable to their situation). The revised Form 886H will be implemented in January 2003.
- ◆ Continuing to refine and clarify all forms, notices and letters, to facilitate taxpayer participation in the examination process, which will reduce the length of EITC examinations.



**TAXPAYER ADVOCATE SERVICE COMMENTS**

*TAS acknowledges the actions taken to reduce the timeframes for EITC audits. The 27 percent decrease in cases more than 365 days old is very significant and reflects the IRS' attention in this area. Although the IRS response does not indicate the reason, improvements in batch processing may have had an impact on inventory.*

*While batch processing allows for more expeditious treatment where a taxpayer does respond, it does not address the problem of high volumes in "no response" cases. Conducting research to better understand and address the reasons for a high "no response" rate in EITC audit process is a clear imperative for increasing taxpayer participation and improving audit results.*

*Use of the "Combo" letter leaves a smaller window of opportunity for the taxpayer to respond timely in writing, or for the IRS to associate taxpayer correspondence with the case before the computer-generated notice of deficiency is sent. The Audit Information Management System, effective January 2003, will alleviate some of the problem by preventing premature issuance of a statutory notice of deficiency. A further problem for taxpayers is that a phone call to the IRS in response to an audit notice does not interrupt the batch processing system cycle, and taxpayers are still required to provide written documentation.*

*Although the IRS comments do not indicate the method, we assume that the reference to simplifying the return selection process is based on the use of the Dependent Database in the selection process of EITC returns.<sup>163</sup> The Wage & Investment Division Fiscal Year 2003 Performance Plan indicates that the total number of Correspondence Examination audits for FY 2002 decreased by 12 percent to 575,000, of which more than 80 percent are EITC.<sup>164</sup> "The decrease reflects the efforts of the IRS to improve targeting of unproductive EITC examinations through full implementation of the Dependent Database and new procedures that allow taxpayers to self-correct errors in lieu of traditional examinations."<sup>165</sup> The identification of high-risk cases early in the process is critical to meeting customers' needs and increasing their satisfaction with the time required for resolution of their issues. In addition, we note in IRS plans that additional time will become available to front line employees through overhead reduction and a decreased demand for assistance during the filing season.<sup>166</sup>*

<sup>163</sup> The Dependent Database, which the IRS uses for electronic selection of EITC cases for examination, is based on a combination of state data and other internal and external sources that can be used as evidence of support and residency of children.

<sup>164</sup> IRS Wage & Investment, Strategy and Finance; Performance Improvement, Strategy Planning and Budget Cycle, Phase 4, FY 2003 IRS Annual Performance Plan. Page PA-63.

<sup>165</sup> *Id.*

<sup>166</sup> W & I Strategy and Finance, Performance Improvement, Strategy Planning and Budget Cycle; "FY 2003 IRS Annual Performance Plan" page PA-44.



*The Taxpayer Advocate Service agrees that investment in electronic risk-based selection, such as the Dependent Database, and electronic processing of tax returns, will alleviate some of the strain on resources in Correspondence Exam.<sup>167</sup> However, we also believe that the reliance on the Dependent Database is premature. The Federal Case Registry Study is currently evaluating data used in the Dependent Database.<sup>168</sup> If the results of the Federal Case Registry Study show that the states' data is not reliable, the IRS should devise a backup plan that will reduce the timeframe for holding refunds.*

*Taxpayer refunds, including any undisputed portions of the refunds, are held pending the outcome of the audits. This policy can have serious economic consequences for taxpayers and has surfaced as a problem in a related section of this report ("Procedures for Examining EITC Claims Cause Hardship," Most Serious Problems #7). Many refunds held are released at least in part (and with interest) at the conclusion of the audit. A recent analysis of EITC returns audited for 1998 indicated that 66 percent of the taxpayers ultimately received refunds.<sup>169</sup> The IRS is considering partial refund release during processing. The National Taxpayer Advocate strongly supports such an approach and looks forward to immediate implementation.*

<sup>167</sup> "EITC Program Effectiveness and Program Management FY1998-2002," page 8. System enhancements will also identify taxpayers who would benefit from alternative treatments, such as soft notices.

<sup>168</sup> The Federal Case Registry (FCR) Study was developed to evaluate the accuracy and timeliness of data contained in FCR database prior to use of the Dependent Database in the Math Error Processing, mandated for Tax Year 2004. The FCR is maintained by the Department of Health and Human Services to which states are required to electronically submit data regarding all child support cases handled by the state Title IV-D child support agencies and all non-Title-D support orders established or modified after October 1, 1998. The Dependent Database, which the IRS uses for electronic selection of EITC cases for examination audit, contains FCR data combined with other internal and external sources that can be used as evidence of support and residency of children.

<sup>169</sup> Tax year 1998, Compliance Research Information System (CRIS), Model IFM 2002.

**PROBLEM****TOPIC #11****EITC RECERTIFICATION COMPOUNDS TAXPAYER BURDEN****IRS RESPONSIBLE OFFICIALS**

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

Taxpayers experience a multitude of problems when they try to recertify their eligibility for the EITC in years after the credit has been disallowed. These problems include:

- ◆ EITC disallowance letters do not give taxpayers an explanation of the documentation necessary to establish EITC eligibility in subsequent years.
- ◆ A blank Form 8862, Information to Claim Earned Income Credit After Disallowance, is not provided at the end of the process; rather, the taxpayer must seek out the form independently.
- ◆ The timing of recertification audits negatively impacts the EITC claims made by the taxpayers for subsequent years.
- ◆ Taxpayers mistakenly receive EITC math error disallowance notices and requests to file the Form 8862 in a subsequent year, because the IRS does not remove recertification indicators from taxpayers' accounts when warranted.
- ◆ The Form 8862 does not advise the taxpayers that the recertification process will delay any refund.
- ◆ The information that taxpayers are required to provide on the Form 8862 is not used in the examination recertification process.
- ◆ The IRS is not meeting contact timeframes promised in IRS letters.

**ANALYSIS OF PROBLEM**

Internal Revenue Code section 32(k) authorizes the IRS to disallow a taxpayer's EITC for any tax year after 1996 if the taxpayer is ineligible for any reason other than a mathematical or clerical error. Taxpayers must "recertify" that they are eligible for the credit the next time they claim EITC by attaching to that return a completed Form 8862, Information to Claim Earned Income Credit After Disallowance. When the IRS receives a recertification request with the tax return, it automatically selects that return for examination.

Problems identified in the 'recertification' process and reported in the FY 2001 Annual Report to Congress are still occurring.<sup>170</sup> The General Accounting Office recently reported

<sup>170</sup> National Taxpayer Advocate's, *FY 2001 Annual Report to Congress*, Publication 2104 (Revision 12-2001) pages 36-38.



that, “Although IRS made some changes to its correspondence, improved its examiner training, and expanded taxpayer outreach, certain aspects of the Recertification process continue to cause problems for taxpayers.”<sup>171</sup>

When the IRS disallows all or part of the EITC claimed, it sends a letter advising the taxpayer that he or she must recertify eligibility for EITC on the next return claiming the credit by completing and attaching Form 8862, Information to Claim Earned Income After Disallowance.<sup>172</sup> The letter also states the IRS may ask for additional documentation. However, the letter does not say what documentation is needed to support residency, relationship, filing status, and other eligibility requirements.<sup>173</sup>

For tax year 1999, the IRS disallowed the EITC or otherwise rejected the return on more than 61,000 paper returns<sup>174</sup> and nearly 75,000 electronically filed ones<sup>175</sup> because taxpayers failed to attach the required Form 8862. An escalating number of the more than 88,000 tax year 2001 EITC claims on paper returns were disallowed because Form 8862 was missing.<sup>176</sup> The IRS explained that it does not enclose Form 8862 with the prior year EITC disallowance letter because of “the time lapse between having the EITC disallowed in one year and the filing of the subsequent year’s return claiming EITC again.”<sup>177</sup> The IRS believes that to do so would invite the taxpayer to incorrectly attach the form to a claim for the disallowed year, or to file it separately before the subsequent year filing. However, in light of the significant number of Forms 8862 omitted from filed returns, it appears problems persist.

The timing of recertification audits remains an issue. Low Income Taxpayer Clinics report a problem frequently occurs when (1) the taxpayer is denied EITC in the first year; (2) files a return the second year accompanied by Form 8862; and (3) the IRS does not complete its audit allowing the second year claim before the due date of the third year. Thus, the IRS will automatically deny the later year claim as a math error, for failure to include a Form 8862 on the third year return, even when the IRS ultimately determines the taxpayer is entitled to the EITC in year two and releases the recertification indicator for that

<sup>171</sup> General Accounting Office, *Earned Income Credit – Opportunities To Make Recertification Program Less Confusing and More Consistent*, GAO-02-449, April 2002.

<sup>172</sup> IRS Computer Paragraph Notice 79 (formerly Letter 3094).

<sup>173</sup> In most instances, the disallowance letter for the prior year is sent at a time when the taxpayer can begin accumulating the proof needed to claim the EITC for the subsequent year. Most EITC audits are closed by the end of the year in which a timely return is filed. If the disallowance letter included examples of the types of supporting documentation needed to recertify, taxpayers would have several additional months to secure that information before filing.

<sup>174</sup> Tax Year 1999, Compliance Research Information System (CRIS), Model IFM 2001.

<sup>175</sup> IRS ELF1545 report dated 4/18/2000.

<sup>176</sup> IRS Wage & Investment, IMF Error Code Report (P/R/F/: 480-62-11) through September 2002.

<sup>177</sup> National Taxpayer Advocate, FY 2001 Annual Report to Congress, page 37.

year. However, if the taxpayer does submit Form 8862, the third year return will be subject to audit and a delayed refund. The lengthy audit cycle creates an endless loop for EITC-eligible taxpayers, and delays refunds for years.

During the 1999 tax year (through September), the IRS failed to remove 11,400 recertification indicators on the records of 19,200 taxpayers for whom EITC was allowed.<sup>178</sup> Local Taxpayer Advocates report this problem persists, particularly when the EITC is fully allowed as the result of the Audit Reconsideration process.<sup>179</sup> The IRS recently issued an Internal Revenue Manual update to clarify that examiners should release the indicator on cases where the EITC is fully allowed even though the filing status and/or dependent exemptions are disallowed.<sup>180</sup> Failure to remove the indicator means future claims for the EITC may be erroneously denied and at the very least results in delayed refunds and taxpayer burden.

Taxpayers are not advised that filing Form 8862, Information to Claim Earned Income Credit After Disallowance, will likely delay their refund, nor for how long. The latest version of the instructions does include the cautionary note, “In addition to filing Form 8862 and, if required, Schedule EIC, you may be asked to provide other information before any refund resulting from the EIC claimed on your return is issued.”<sup>181</sup> However, this statement does not go far enough in explaining the likelihood of the delay. For fiscal year 2001, the average cycle time for an EITC audit was 265 days (cumulative through July).<sup>182</sup> The length of the process and lack of information about timeframes result in unnecessary taxpayer contacts with the Taxpayer Advocate Service. Local Taxpayer Advocates report that many taxpayers believe that completing Form 8862 will grant the claim immediately.

Though there is significant burden to the taxpayer in completing Form 8862, the IRS does not routinely review or utilize the form in conducting the examination.<sup>183</sup> The IRS

<sup>178</sup> Treasury Inspector General for Tax Administration, *Improvements Are Needed in the Earned Income Credit Recertification Program*, Reference Number: 2001-40-030, December 2000.

<sup>179</sup> Audit reconsideration is an IRS procedure designed to help taxpayers when they disagree with the results of an IRS audit. The taxpayer must not have signed an agreement, should have information that the IRS did not previously consider which might change the determination, and the taxpayer provides a copy of the audit report. (IRS Publication 3598, *What You Should Know About The Audit Reconsideration Process* (Rev. July 2000).

<sup>180</sup> IRM Procedural Update, W 02642, September 26, 2002.

<sup>181</sup> Instructions for Form 8862, Information To Claim Earned Income Credit After Disallowance (Rev. November 2000).

<sup>182</sup> IRS Wage & Investment, Director, Examination Strategy and Selection, EITC Advisory Council Meeting, September 2002.

<sup>183</sup> Form 8862 includes two pages of instructions and two pages of questions for the taxpayer to answer regarding each EITC qualifying child. The IRS estimates that it takes an average of approximately 2 hours 19 minutes to keep records, learn about the law or the form, prepare, copy, assemble and send the Form 8862 to the IRS. (Instructions for Form 8862, Information to Claim Earned Income Credit After Disallowance, Paperwork Reduction Act Notice, Rev. November 2000).



does not transcribe or otherwise use the information provided on the form.<sup>184</sup> When attached to the tax return, the form serves merely as a flag in the system to initiate the recertification process. When the return is flagged, the taxpayer's entire refund is frozen while the examiner reviews the return information (not the Form 8862) to determine whether to perform a full audit. If the review indicates an EITC audit is appropriate, letters are sent requesting documentation to substantiate eligibility for the credit. In a 1999 report, the U.S. General Accounting Office (GAO) recommended that the IRS cease using Form 8862 if it is not needed for recertification purposes.<sup>185</sup> In a follow-up report, GAO stated "IRS did not eliminate the form because it said it relies on the form to 'identify the type of action to be taken for taxpayers required to recertify.'"<sup>186</sup> In practice, however, it does not benefit taxpayers to answer two pages of questions on the form including the child's relationship to the taxpayer, the addresses where the taxpayer lived with the child, and the name of the school or day care provider.

Once a refund is withheld, the IRS is not adhering to timeframes that it gives taxpayers on the initial notice of a possible audit (CP 75A). This initial letter states that taxpayers will be notified within 30 days if their return will be examined or, if not examined, given the status of their refunds within eight weeks. Taxpayers and practitioners have reported the second letter is delayed or often never received.<sup>187</sup> These taxpayers believe they deserve timely and informed treatment concerning their claims.

### IRS COMMENTS

We agree that taxpayers experience problems when they attempt to recertify eligibility for EITC. These problems are often directly related to the lack of taxpayer awareness of the EITC requirements in general and more specifically, the requirements to recertify eligibility for the credit after it has been disallowed.

The lack of taxpayer participation in the examination process also contributes to recertification problems. When taxpayers do not participate, the examination process is prolonged and there is an increased likelihood that another return will be filed and selected for examination prior to the completion of the examination of the first return.

In addition, the Service will continue to identify improvements to the recertification process that will reduce the current issues some taxpayers encounter.

<sup>184</sup> The form does not require the taxpayer to list the name or social security number of the EITC qualifying child, for example.

<sup>185</sup> U.S. General Accounting Office, *Tax Administration: IRS' 1999 Tax Filing Season*, GAO/GGD-00-37 (Washington, D.C.: December 15, 1999).

<sup>186</sup> U.S. General Accounting Office, *Earned Income Credit – Opportunities to Make Recertification Program Less Confusing and More Consistent*, GAO-02-449 (Washington, D.C.: April 2002).

<sup>187</sup> The second notification is a combination letter advising the taxpayer that he or she has been selected for audit and includes a computation of the proposed changes (generally Letter 566 series).

**IRS INITIATIVES TO RESOLVE PROBLEM**

The National Taxpayer Advocate's 2001 Report to Congress acknowledges that IRS has made some changes to its correspondence, improved its examiner training and expanded taxpayer outreach. The IRS is taking the following additional steps to improve the recertification process by:

- ◆ Initiating a research study to evaluate the recertification process including the effectiveness of Form 8862, Information to Claim Earned Income Credit After Disallowance. Revisions to the form that will improve communication, reduce taxpayer burden and aid the recertification/examination processes will be a primary focus. Initial recommendations from this study should be completed by June 2003.
- ◆ Revising the EITC disallowance letter based on the recommendations of the Taxpayer Advocate EITC Task Force. This revised letter (released in September 2002) now includes information concerning the possibility of future examinations, and the related documentation requirements. In addition, the revised letter provides a website and telephone number to assist taxpayers in obtaining Form 8862.
- ◆ Creating monthly reports for all campuses that identify any cases with recertification indicators that should have been removed. These reports will be used by campus personnel as a tool to ensure that indicators are removed from the taxpayer accounts in a more timely fashion. Actions have also been initiated to have the recertification indicators systemically removed. This program change is scheduled for implementation in FY 2004.

**TAXPAYER ADVOCATE SERVICE COMMENTS**

*We commend the IRS on its establishment of the task force to review the recertification process and the Form 8862 in partnership with Wage and Investment, Office of Research. Notably, the Taxpayer Advocate Service has also been invited to participate in this process that we expect will generate solutions to reduce taxpayer burden while ensuring adherence to the tax laws.*

*The IRS acknowledges that many recertification problems are caused by the taxpayers' difficulty in understanding EITC rules and in documenting eligibility. We encourage the IRS to take every opportunity to fill the void in taxpayers' understanding through education, outreach, and individual taxpayer contact. We are pleased to note the IRS has revised the EITC disallowance notification (CP79/79A) to include the EITC eligibility documentation requirements among other useful changes. This change will give taxpayers much-needed additional time to provide required items. We look forward to reviewing the final version.*



*An additional opportunity for guidance may have been overlooked. The IRS Publication 596, Earned Income Credit, and the EITC instructions should contain a section entitled “What You May Have to Furnish the IRS if Your EITC Eligibility is Questioned.”*

*Failure to attach Form 8862, Information to Claim Earned Income Tax Credit After Disallowance, is the fifth largest of the approximately 24 categories of EITC math errors caused by taxpayers.<sup>188</sup> While the IRS is unclear about the occurrence, in recognizing the problem the IRS decided to place a contact website and telephone number on the disallowance notice to facilitate the taxpayer’s obtaining the blank Form 8862. This is a step in the right direction. We are puzzled, however, as to why the form is not included in Form 1040 series tax packages for the particular taxpayers who are required to recertify, using the recertification indicator as a trigger. Though including the form in the tax package would be the practical solution, an alternative recommendation would be to target a mailing of the form to the appropriate taxpayers.*

*In December of each year, the IRS should consider generating to all taxpayers whose accounts have recertification indicator “1” a letter explaining the recertification process, including their right to appeal, and enclosing the blank Form 8862. The mailing should advise the taxpayer of the circumstances in which to attach the completed Form 8862 to the subsequent year tax return.*

*We are pleased that the IRS has revised instructions to Form 8862 in its November 2002 edition to advise “...The process of establishing your eligibility to take the EITC will delay your refund.” This statement should lessen taxpayer frustration resulting from recertification processing delays.*

*Taxpayers required to recertify because of a disallowed child in the prior year often stop claiming the disallowed child in the current year and claim only the income-based EITC.<sup>189</sup> Under current procedures (Processing Year 2002), the EITC refund is automatically held under the recertification procedures and is subsequently released manually by an examiner. A 2001 TIGTA (Treasury Inspector General for Tax Administration) recommendation, subsequently approved by the IRS, requires recertification only if the taxpayer claims EITC in the current year based on the same reason it was denied in the prior year.<sup>190</sup> IRS should implement programming to systemically identify these claims and without delay issue the refunds under these circumstances.*

*The National Taxpayer Advocate also recommends the following changes to the Recertification Program procedures that may serve to enhance the program’s effectiveness and reduce taxpayer burden:*

- ◆ *The IRS should consider allowing the Service Center Error Resolution Function to correspond for missing Forms 8862 rather than to immediately disallow the EITC using the math error procedures.*

<sup>188</sup> Tax Year 1999, Compliance Research Information System (CRIS), IFM 2000.

<sup>189</sup> IRC § 32(c)(1)(A)(ii).

<sup>190</sup> Treas. Reg. § 1.32-3.



- ◆ *The IRS should require tax examiners to simultaneously address all open tax returns claiming EITC to prevent taxpayers having to submit some of the same information numerous times to different employees and to prevent various determinations being made.*
- ◆ *Removal of any expired or erroneous recertification indicator from a taxpayer's account is critical to normal processing since failure to do so unnecessarily delays the refund. It is commendable that programming to alleviate the problem of erroneous indicators is scheduled for 2004. However, in the interim, we encourage the IRS to emphasize the importance of manually removing the indicators with IRS campuses based on monthly reports.*



## PROBLEM

### TOPIC #12

### LANGUAGE & CULTURAL BARRIERS IMPACT TAXPAYER COMPLIANCE

#### IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage & Investment Division

Judy Tomaso – Office of Tax Administration Coordination

John M. Robinson – Office of Equal Opportunity Employment & Diversity

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

#### DEFINITION OF PROBLEM

The demographics of multilingual or English-as-a-Second-Language (ESL) taxpayers present unique challenges for tax administrators.<sup>191</sup> New arrivals to the United States often live below the poverty level and possess little understanding of the U.S. tax system and its cultural doctrine of voluntary compliance. Preparing tax returns, claiming the Earned Income Tax Credit (EITC), communicating with the IRS, responding to IRS letters or notices, and understanding taxpayer rights are particularly vexing. ESL taxpayers have a unique incentive to seek tax preparation assistance. They rely on preparers at a higher rate because of the complexity of federal tax laws, literacy problems, IRS compliance initiatives, and fear of the IRS.<sup>192</sup>

English-as-a-Second-Language taxpayers acutely need services in post-filing tax controversies.<sup>193</sup> In the return examination process, for example, cultural or behavioral differences present unique challenges for the auditor and taxpayer. The IRS may not always be sensitive to the particular characteristics of a taxpayer's situation, which might require the auditor to do some additional probing. To complicate matters further, ESL taxpayers receive IRS notices that are not written in their native language.

#### ANALYSIS OF PROBLEM

Early results from the 2000 U.S. Census noted a significant growth in the non-English speaking or multilingual population over the past decade. In particular, the Census highlighted the increase in Hispanic/Latino sector, now the fastest growing U.S. minority. Their numbers increased by 58 percent during the 1990s, from 22.4 million to 35.3 million. Hispanics now represent the largest ethnic/racial group in the U.S. (12.5 percent).<sup>194</sup> The Census also revealed that in a number of metropolitan areas, the majority of the pop-

<sup>191</sup> ESL taxpayers are sometimes referred to as Limited English Proficiency or (LEP) taxpayers.

<sup>192</sup> Michael O'Connor, *Tax Preparation Services for Lower-Income Filers: A Glass Half Full, or Half Empty?* 2001 Tax Notes Today, 5-106.

<sup>193</sup> Leslie Book, *Tax Clinics: Past the Tipping Point and to the Turning Point*, 2001 Tax Notes Today 161-75, August 2001.

<sup>194</sup> The Brookings Institution, Center on Urban & Metropolitan Policy and The Pew Hispanic Center, *Latino Growth in Metropolitan America: Changing Patterns, New Locations*, July 2002.

ulation is multilingual and speaks a language other than English.<sup>195</sup> Take, for example, the results from the following fast-growing population centers:

**TABLE 1.12.1**  
**PERCENT SPEAKING A LANGUAGE OTHER THAN ENGLISH**

Santa Anna CA (Orange County)	83.6
Miami Fl	75.9
El Paso TX	73.2

**TABLE 1.12.2**  
**PERCENT SPEAKING SPANISH AT HOME:**

Santa Anna CA (Orange County)	74.0
El Paso TX	69.5
Miami Fl	66.0

The problems impacting ESL taxpayers can generally be categorized into two broad areas: language barriers rooted primarily in limited English language proficiency; and cultural barriers that are unfamiliar to tax administrators or unrecognized by the tax system.

For example, unenrolled tax preparers flourish in many ethnic communities. Often these businesses operate only during filing season and close their doors on April 16, thereby being unavailable to help their customers cope with follow-up notices from the IRS. Low income taxpayer clinics have reported that even if these offices are still in business, many are unwilling to assist with subsequent notices.

Most IRS literature (tax forms, instructions, notices, etc.) is not printed in languages other than English.<sup>196</sup> For example, a Spanish version of Form 1040 is not available.<sup>197</sup> The IRS is engaged in initiatives designed to address the needs of taxpayers with limited English proficiency.

The IRS does not issue a Spanish version of letters to taxpayers whose EITC claims are being examined (e.g. Letter 566-B or statutory notice of deficiency). Currently, examiners use locally translated letters. (Several EITC publications are, however, printed and available in Spanish.) IRS notices and letters in English are difficult or sometimes impossible for taxpayers with limited English proficiency to comprehend. As a result, many do not

<sup>195</sup> U. S. Census Bureau, *Census 2000 Supplemental Survey*, available at <http://www.census.gov> (November 6, 2002).

<sup>196</sup> A limited number of IRS tax documents have Spanish versions, none of which are printed in languages other than English and Spanish. IRS Digital Daily, Forms and Publications, available at <http://www.irs.gov/individuals/index.html>.

<sup>197</sup> Tax Administration Council Minutes, June 17, 2002.



respond to letters or notices, and are thus unaware of and suffer the consequences of not responding.

The IRS also has no Spanish letters for taxpayers whose returns are subject to the Underreporter Program, so ESL taxpayers are further handicapped in communication with the IRS. ESL taxpayers also have specialized needs in the process of filing Form W-7, and in obtaining Individual Taxpayer Identification Numbers (ITINs).<sup>198</sup> The IRS requires all foreign and domestic taxpayers to provide either a Social Security Number (SSN) or an ITIN when filing returns. While IRS personnel are generally aware that ITINs are not valid for claiming the EITC, there is no requirement to inform immigrants who are later issued a SSN that they can amend a return filed under an ITIN and claim the EITC for any open tax year.

IRS has no way to determine the language spoken by taxpayers to facilitate communication when they enter the tax system.

#### IRS COMMENTS

Language barriers represent a problem for all federal agencies and the IRS has recognized for many years that language can be a major barrier for Limited English Proficient (LEP) taxpayers - referred to as “multilingual” by the Taxpayer Advocate - in fully exercising their tax rights and responsibilities. Even before the President signed Executive Order 13166 in August 2000 requiring all federal agencies to “improve access to services for persons with Limited English Proficiency,” the IRS was providing a growing number of products and services to address the needs of LEP taxpayers.

These efforts became even more focused in 1998 with the enactment of the Restructuring and Reform Act of 1998 (RRA98). Two Sections of the Act spoke directly to language issues: Section 3705(c) required the establishment of Spanish telephone help-lines and Section 1203 (b)(3) established the External Civil Rights Unit (ECRU) which was tasked with addressing allegations filed by taxpayers who alleged violation of the Title VI of the Civil Rights Act of 1964.

The IRS followed in 1999 with an official Policy Statement (P-6-41) on multilingual services, in 2000 with the start up of the Spanish telephone helpline, and in 2001 with the establishment of the Multilingual (MLI) Project Office to oversee a five-year Servicewide Multilingual Strategy. This Office was charged by the Commissioner to ensure that the goals of IRS Policy Statement were attained: “*The IRS commits to provide top quality service to*

<sup>198</sup> The ITIN is used by alien individuals who are required to furnish a United States Taxpayer Identification Number to the IRS but who do not have, and are not eligible to obtain, a social security number. Form W7, Application for IRS Individual Taxpayer Identification Numbers, is used to apply for an ITIN. An ITIN is intended for tax use only. (IRC § 6109; Regs. sec. 301.6109-(d)).

*each taxpayer, including those who lack a full command of the English language. The needs of these taxpayers will be included in the agency strategic and tactical plans consistent with available resources. Our workforce will have the essential tools necessary to interact appropriately with our diverse taxpayer base.”*

In addition to the Taxpayer Advocate’s analysis of the problem, we are focusing on the larger demographic picture of which LEP taxpayers are a part. Data from the 2000 Census shows that over 10.4 million U.S. residents are LEP, denoting that they speak a language other than English and speak English either not well or not at all. This represents 3.8 percent of the total U.S. population. Spanish speakers represent 71 percent of that segment which equates to 3.2 million of the total LEP population. The remaining 29 percent of the LEP population is comprised of over 100 other languages or language groups.

Although the IRS is aware that projections for 2005 indicate these numbers will increase, the Service has an obligation to use its increasingly constrained resources where they will serve the maximum number of taxpayers. To date the emphasis for other-than-English has been placed on the Spanish language, as an attempt to address all languages would be cost prohibitive. The focus of the Multilingual Strategy has been to balance our sincere desire to serve all taxpayers with a realistic assessment of where resources will best be used. The following section focuses on the current MLI initiatives to identify where those resources best serve the taxpayer with limited English proficiency.

#### **IRS INITIATIVES TO RESOLVE PROBLEM**

In November 2000, MLI teams, consisting of IRS personnel, the National Treasury Employees Union (NTEU) and the Hispanic Internal Revenue Employees (HIRE) organizational representatives, were established to develop recommendations for improvement and expansion of IRS products and services for LEP taxpayers. The Taxpayer Advocate Service was invited to join these teams. The teams, initially focusing on the needs of the Spanish-speaking taxpayer, developed thirty-two recommendations in seven areas:

- ◆ Telephone Services
- ◆ Notices, Forms, Letters, Publications
- ◆ Monitoring and Tracking of Spanish-Language Correspondence
- ◆ Processes for Assessing Bilingual Services
- ◆ Training/Tools for Employees
- ◆ Internal and External Communications
- ◆ Outreach and Taxpayer Education.



The scope of these efforts is comprehensive but we will focus our response on the specific issues that the National Taxpayer Advocate has raised regarding service to taxpayers with Limited English Proficiency.

The National Taxpayer Advocate's analysis that "a limited number of IRS tax documents have Spanish versions (and) none are printed (in) other languages" significantly understates the number of IRS products. There are over 246 official IRS forms, letters, notices and publications available in Spanish and a growing, unofficial number of documents in other languages such as Chinese, Russian and Vietnamese. Employees who are fluent and have voluntarily produced translations provide these. As part of the MLI effort, in January 2003 the IRS will identify the next five languages for "official" translation of products and services.

Although the documents that the National Taxpayer Advocate mentions in her report are certainly important, for the moment the IRS is focusing on the input that is coming directly from Spanish-speaking taxpayers and their organizational representatives. To ensure that we are translating the documents deemed important by that community, this year the IRS worked with representatives of the Taxpayer Advocate Service to contact over 140 Low Income Taxpayer Clinics and Tax Clinics for the Elderly, three out of the four Citizen Advocacy Panels, the Congressional Hispanic Caucus, the Association of Latino Professionals in Finance and Accounting, the League of Latin American Citizens and the Internal Revenue Service Advisory Council. The short list of documents that came from that research of our external stakeholders is now being matched up with the research on customer needs that is going on throughout the Service. That research includes the recent Hispanic Communication Initiative, customer service studies by the front-line IRS service providers and several recently established systems to track and measure demand for Spanish language products and services. Thus it is also incorrect that the "IRS has no process in place to determine the language spoken by taxpayers" as noted by the National Taxpayer Advocate.

The IRS has already identified the issue of Form W-7 and ITINs noted by the National Taxpayer Advocate and has revised and simplified the Spanish version of the W-7 for Filing Season 2003 and has improved the ITIN program training. Posters in Spanish that explain taxpayer's Civil Rights and the complaint process are being distributed to geographic areas in which there is a substantial Spanish-speaking customer base. In February 2003, the IRS will begin testing the addition of a line in Spanish on Examination and Automated Underreporter communications that would provide Spanish-speaking taxpayers a phone number to request the communication in Spanish.

To supplement the needs of taxpayers where we do not currently have translated documents, over-the-phone (OPI) translation services are now offered in all 406 taxpayer assistance centers. OPI is an easy to use, cost-effective service that allows IRS employees to communicate with limited or non-English speaking taxpayers through the use of an interpreter. The service is accessed from any telephone, enabling a three-way telephone conversation with the IRS employee, taxpayer and an interpreter. The only equipment needed is a telephone with a second handset or a speakerphone. OPI services over 140 languages and regardless of the language, a translator is always available.

There are now 24 kiosks around the nation with Spanish language information. Additionally, the IRS has expanded its Spanish help-lines, implemented Spanish language training and Spanish tools for those employees on the Spanish phone lines, established a cadre of Spanish-speaking trainers to deliver training to the phone assistants and expanded the Tele-Tax system to include Spanish language scripts.

The issue of unscrupulous practitioners operating in communities with limited English proficiency is one that also concerns the IRS. We believe that this issue, while it may be more pronounced in a community with large numbers of people with limited English proficiency, is part of the larger issue of the oversight of paid preparers which is addressed in this report (Section on “IRS Oversight of EITC Return Preparers Can Be Improved.”) As noted in that section, paid preparers are not subject to the standards of Circular 230, “The Rules That Govern Practice before the IRS.” Putting the Paid Tax Preparers on equal footing with Certified Public Accountants, Attorneys and Enrolled Agents in terms of Circular 230 will advance the cause of providing better tax services to both the English-speaking taxpayer as well as the taxpayer with limited English proficiency.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*The efforts to increase outreach to the English-As-a-Second-Language (ESL) population are evident in the new Wage and Investment Division with responsibility for oversight and administration of the IRS Multilingual Initiative (MLI). Multilingual initiatives, with participation across all IRS operating divisions and functions, provide expanded customer service and public outreach programs to assist Spanish-speaking and other Limited English-Proficient taxpayers in meeting their tax obligations.*

*Despite these impressive efforts, TAS remains concerned that ESL taxpayers do not understand IRS notices or letters, or the consequences of failing to respond to them. We do not believe that the IRS has addressed our concern that there is no process in place to determine the language spoken by taxpayers at the outset of their interaction with the tax system rather than further into the examination or collection stream. Tracking and measuring “demand for Spanish language products and services” is not the*



*same thing as identifying, up front, a particular taxpayer's need for communications in Spanish from the beginning of his or her interactions with the IRS. Development of a check box on the tax return to identify the preferred language for taxpayer contact could facilitate communication. If transcribed and posted to the taxpayer's account during processing, this "preferred language indicator" would cause subsequent letters and notices to be printed in Spanish initially, and in other languages as the technology expands. The indicator could also prompt IRS notices to print the applicable IRS contact telephone number best suited to help the taxpayers in Spanish, or other desired language.*

*The strategy currently under development, aimed at assisting ESL taxpayers, understanding population behavior, identifying and handling unique taxpayer treatments and improving taxpayer participation, is commendable. Enhanced diversity or sensitivity training can help employees understand cultural differences and comprehend why, for example, a taxpayer may not be able to provide the requested documentation, and help this taxpayer provide alternates.*

*However, the IRS should explore not just the demographics of this population (or populations, given the diversity of the multi-lingual community). Many programs – federal, state, for-profit, and non-profit – have developed attitudinal, cultural, and psychographic profiles of various immigrant communities in the United States. The IRS should utilize this readily available information when designing audit programs, initiating collection contacts, and developing outreach strategies to the ESL community. Rather than "translating" current IRS strategies and imposing them on the ESL population, a more productive approach would entail designing a strategy that fits the characteristics of the target population.*

*Although we are pleased by the IRS' progress in translating forms and publications into Spanish, and its efforts to work with the Spanish speaking community and its advocates, it is simply unacceptable that the statutory notice of deficiency is unavailable in Spanish. The significance of this notice for taxpayer rights and due process cannot be understated. The Notice of Deficiency as defined under IRC § 6212 provides the taxpayer with a 90 day window within which to petition the United States Tax Court to protest a deficiency in tax **before** it is assessed and **before** it is paid.<sup>199</sup> Regardless of whether Spanish speaking taxpayers or their representatives identify this notice as important, the IRS, on its own initiative and because of its understanding of the importance of this notice should immediately undertake the translation of the Notice of Deficiency into Spanish. The National Taxpayer Advocate will monitor this closely.*

<sup>199</sup> IRC § 6213(a), Restrictions applicable to deficiencies; petition to Tax Court.



**PROBLEM**

TOPIC #13

**FREE U.S. INDIVIDUAL INCOME TAX RETURN PREPARATION****IRS RESPONSIBLE OFFICIALS:**

John Dalrymple – Commissioner, Wage & Investment Division

**DEFINITION OF PROBLEM:**

Low income taxpayers face numerous hurdles in obtaining free tax preparation and electronic filing.

- ◆ The Internal Revenue Service limits the resources available for free tax preparation in Taxpayer Assistance Centers (TACs), despite a demonstrated need by low income taxpayers.
- ◆ Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs do not always provide electronic filing.
- ◆ Low income taxpayers without electronic access or filing capabilities will not be able to benefit from the EZ-Tax Filing Initiative.

**ANALYSIS OF PROBLEM:****Taxpayer Assistance Centers:**

The IRS instituted uniform guidelines for Form 1040 return preparation in the IRS Taxpayer Assistance Centers (“Walk-in Offices”) in fiscal year 2001. In prior years, local IRS executives determined which offices would provide return preparation services. This approach resulted in inconsistent service throughout the country.

In January 2001, the IRS issued nationwide standards for return preparation. The criteria for fiscal years 2001 and 2002 are shown in table 1.13.1



**TABLE 1.13.1**  
**TAX RETURN CRITERIA IN TAXPAYER ASSISTANCE CENTERS TAC FOR FY 2001 AND 2002**

TAC CRITERIA	FISCAL YEAR 2001 <sup>200</sup>	FISCAL YEAR 2002 <sup>201</sup>
<b>Current Filing Tax Year</b>	2000 U.S. Individual Income Tax Return	2001 U.S. Individual Income Tax Return
<b>Income Limits</b>	Less than or equal to \$41,000 Adjusted Gross Income	Less than or equal to \$33,000 Adjusted Gross Income
<b>Forms</b>	<ul style="list-style-type: none"> <li>• Form 1040, U. S. Individual Income Tax Return</li> <li>• Form 1040A, U.S. Individual Income Tax Return</li> <li>• Form 1040-EZ, Income Tax Return for Single and Joint Filers with No Dependents</li> </ul>	<ul style="list-style-type: none"> <li>• Form 1040, U. S. Individual Income Tax Return</li> <li>• Form 1040A, U.S. Individual Income Tax Return</li> <li>• Form 1040-EZ, Income Tax Return for Single and Joint Filers with No Dependents</li> </ul>
<b>Schedules</b>	<ul style="list-style-type: none"> <li>• Schedule A, Itemized Deductions</li> <li>• Schedule EIC, Earned Income Credit</li> <li>• Schedule R, Credit for the Elderly or the Disabled</li> <li>• Schedule B, Interest Only</li> </ul>	<ul style="list-style-type: none"> <li>• Schedule A, Itemized Deductions</li> <li>• Schedule EIC, Earned Income Credit</li> <li>• Schedule R, Credit for the Elderly or the Disabled</li> <li>• Schedule C-EZ, and Schedule SE Self-Employment Tax (in conjunction with C-EZ only).</li> <li>• Schedule B, Interest Only</li> </ul>
<b>Other Forms</b>	Form 2290, Heavy Vehicle Use Tax Return	<ul style="list-style-type: none"> <li>• Form 2290, Heavy Vehicle Use Tax Return</li> <li>• Form 2441, Child and Dependent Care Expenses</li> <li>• Form 8812, Additional Child Tax Credit</li> <li>• Form 8839, Qualified Adoption Credits</li> <li>• Form 8863, Education Credits</li> </ul>
<b>Excluded</b>	<ul style="list-style-type: none"> <li>• Schedule C - Profit or Loss From Business</li> <li>• Schedule D – Capital Gains and Losses</li> <li>• Schedule E – Supplemental Income and Loss or</li> <li>• Schedule F – Profit or Loss From Farming</li> <li>• Form 2106, Employee Business Expenses</li> <li>• Schedule B, Dividend Only</li> </ul>	<ul style="list-style-type: none"> <li>• Schedule C - Profit or Loss From Business</li> <li>• Schedule D – Capital Gains and Losses</li> <li>• Schedule E – Supplemental Income and Loss or</li> <li>• Schedule F – Profit or Loss From Farming</li> <li>• Form 2106, Employee Business Expenses</li> <li>• Schedule B, Dividend Only</li> </ul>

<sup>200</sup> Field Assistance Operational Procedures for Fiscal Year 2001.

<sup>201</sup> Field Assistance Operational Procedures for Fiscal Year 2002.

The Taxpayer Assistance Centers (TACs) provide return preparation on a first-come, first-served basis, but resources limit the number of customers the centers can handle. Each office stops assisting taxpayers when the maximum capacity for any given day is reached, which means taxpayers must often come back several times to obtain services.<sup>202</sup>

In addition to tax return preparation for qualifying individuals, TAC provides the following services:

- ◆ Account inquiries and adjustments
- ◆ Payments/payment arrangements
- ◆ Tax law assistance
- ◆ Procedural inquiries
- ◆ Securing Individual Taxpayer Identification Numbers
- ◆ Multilingual assistance
- ◆ Securing copies of tax returns and transcripts
- ◆ Copies of tax forms
- ◆ Alien clearance

Taxpayers filed more than 124 million individual returns during calendar year 2000 and 126 million during calendar year 2001.<sup>203</sup> Table II compares the volume and percentage of returns prepared by different types of preparer. For both years, approximately 31 percent of the returns filed – representing 38 million taxpayers – were at income levels that qualified for the Earned Income Tax Credit.

**TABLE 1.13.2**  
**TAX RETURNS BROKEN DOWN BY TYPE OF PREPARER, 2000 & 2001**

PREPARER TYPE	CALENDAR YEAR 2000 <sup>204</sup> TAX RETURN PERIOD 1999		CALENDAR YEAR 2001 <sup>205</sup> TAX RETURN PERIOD 2000	
	VOLUME	PERCENTAGE	VOLUME	PERCENTAGE
Paid Preparer	67,899,473	54.5	67,829,748	53.5
Self	55,199,230	44.3	57,469,999	45.4
TAC	292,887	.2	325,659	.3
VITA	648,526	.5	596,539	.5
TCE	479,012	.4	518,094	.4
<b>Total</b>	<b>124,519,128</b>	<b>100</b>	<b>126,767,039</b>	<b>100</b>

<sup>202</sup> IRS Field Assistance Operational Procedures for fiscal year 2002.

<sup>203</sup> Tax Year 1999, Compliance Research Information System (CRIS), Model IFM 2000, and Tax Year 2000 Compliance Research Information System (CRIS), Model IFM 2001.

<sup>204</sup> Tax Year 1999, Compliance Research Information System (CRIS), Model IFM 2000.

<sup>205</sup> Tax Year 2000, Compliance Research Information System (CRIS), Model IFM 2001.



IRS Operations' Strategic Plan for fiscal year 2003 indicates a planned reduction of 25 percent in tax return preparation.<sup>206</sup> The number of returns prepared for calendar year 2002 was not available. However, based on data for calendar years 2000 and 2001, the average number of returns prepared by TACs was about 309,000. A 25 percent reduction would result in over 77,000 low income taxpayers not receiving assistance.

The Director of Field Assistance stated that the IRS justification to reduce resources is based on the fact that 25 percent of available resources are used to serve the 10 percent of taxpayers who request assistance with tax return preparation.<sup>207</sup>

There is currently no method of tracking the total volume of taxpayers not assisted or turned away due to lack of resources.<sup>208</sup>

### VITA and TEC Programs

The Stakeholder Partnership, Education & Communication (SPEC) organization in the Wage & Investment Division trains volunteers to help prepare basic returns for taxpayers with low or limited incomes, individuals with disabilities, English as a second language (ESL) and elderly taxpayers through the Volunteer Income Tax Assistance (VITA) program. The volunteers work at neighborhood centers, libraries, schools, churches, shopping malls and other locations. Some of these locations offer limited electronic filing at no charge.

SPEC also administers Tax Counseling for the Elderly (TCE), a grant program to organizations that offer free tax help to people aged 60 or older. Volunteers visit retirement homes, neighborhood sites, or the houses of the homebound in addition to preparing returns in public locations. Some of these organizations offer free electronic filing.<sup>209</sup>

With the reduction of return preparation at TACs, IRS expects various VITA/TCE sites to supplement the services previously provided by the TAC offices. A recent study by the Treasury Inspector General for Tax Administration (TIGTA) indicated that SPEC has several barriers to overcome before achieving this goal.<sup>210</sup> These barriers include:

<sup>206</sup> Fact Sheet, *Return Preparation in IRS Taxpayer Assistance Centers*, rev. 10/2/02.

<sup>207</sup> Per interview conducted with Director of Field Assistance on July 11, 2002.

<sup>208</sup> Per Field Assistance Operational Procedures for fiscal year 2002, Appendix A, the taxpayers cannot call to make an appointment and must travel to the TAC to obtain an appointment. The appointment may not be on that day, which would require the taxpayer to make a second trip to the office for return preparation. The taxpayer must provide the social security card (not just number) for all individuals filing and dependents. If a joint return is being filed, both husband and wife must come to the office together. If the taxpayer does not know these requirements in advance, he or she must make a return trip to the TAC.

<sup>209</sup> To qualify for the TCE cooperative agreement an organization must be a non-profit (IRC section 501) organization and experienced in coordinating volunteer programs, preferably with some experience in income tax preparation. <http://www.egrants.irs.gov/index.htm>.

<sup>210</sup> Treasury Inspector General for Tax Administration, *The Internal Revenue Service Needs to Improve the Pre-Filing Tax Services Provided to Taxpayers*, Reference Number: 2002-40-174, September 2002.

- ◆ Reduction of approximately 1,000 volunteer sites.
- ◆ Staffing shortages.
- ◆ Inadequate computer equipment for VITA.
- ◆ Shortage of technical assistance.<sup>211</sup>

The free services provided by TACs, VITA and TCE prepared a total of 1.1 percent of all returns filed for tax years 1999 and 2000. The following tables demonstrate the volume of filers meeting the income eligibility criteria for EITC based on income levels, dependents, and method of filing.

The data in Tables 1.13.3 and 1.13.4 shows the ratios of the three primary free services offered to taxpayers (IRS/TAC, VITA and TCE). Of those, the TACs helped prepare returns for only two-tenths of one percent of the total returns filed.

**TABLE 1.13.3**  
**TAX YEAR 1999 RETURNS FILED BY INCOME LEVEL AND SERVICES USED**<sup>212</sup>

	<b>1999 INCOME ELIGIBILITY LIMIT OF \$10,200 WITH NO DEPENDENTS (PERCENT)</b> <sup>213</sup>	<b>1999 INCOME ELIGIBILITY LIMIT OF \$26,928 WITH ONE DEPENDENT (PERCENT)</b> <sup>214</sup>	<b>1999 INCOME ELIGIBILITY LIMIT OF \$30,580 WITH TWO OR MORE DEPENDENTS (PERCENT)</b> <sup>215</sup>	<b>1999 TOTAL RETURNS FILED FOR ALL LEVELS OF INCOME (PERCENT)</b>
<b>Paid Prepared</b>	41.3	65.1	69.2	54.5
<b>Self-Prepared</b>	57.2	33.3	29.4	44.3
<b>TAC Prepared</b>	0.4	0.5	0.4	0.2
<b>VITA Prepared</b>	0.6	0.8	0.9	0.5
<b>TCE Prepared</b>	0.5	0.3	0.1	0.4
<b>Total</b>	100.0	100.0	100.0	100.0

<sup>211</sup> “Technical assistance includes delivery and setup of computers at volunteer sites, installation and updates of the necessary software needed to e-file tax returns, and troubleshooting and fixing problems with the computers.” *The Internal Revenue Service Needs to Improve the Pre-Filing Tax Services Provided to Taxpayers*, Reference Number: 2002-40-174, TIGTA, dated September 2002, page 12.

<sup>212</sup> The total data figures were stratified to provide the potential number of individuals that meet the income and/or exemption levels for earned income credit for the 1999 U.S. Federal Income Tax Return. The actual number of individuals that qualified for earned income credit will vary. Tax Year 1999, Compliance Research Information System (CRIS), Model IFM 2000.

<sup>213</sup> \$10,200 is the 1999 income eligibility limit for the childless taxpayer claiming EITC. Field Assistance Operational Procedures for Fiscal Year 1999.

<sup>214</sup> \$26,928 is the 1999 income eligibility limit for taxpayers claiming EITC with one dependent. Field Assistance Operational Procedures for Fiscal Year 1999.

<sup>215</sup> \$30,580 is the 1999 income eligibility limit for those claiming EITC with two or more dependents. Field Assistance Operational Procedures for Fiscal Year 1999.



**TABLE 1.13.4**  
**TAX YEAR 2000 RETURNS FILED BY INCOME LEVEL AND SERVICES USED** <sup>216</sup>

	<b>2000 INCOME ELIGIBILITY LIMIT OF \$10,380 WITH NO DEPENDENTS (PERCENT)</b> <sup>217</sup>	<b>2000 INCOME ELIGIBILITY LIMIT OF \$27,413 WITH ONE DEPENDENT (PERCENT)</b> <sup>218</sup>	<b>2000 INCOME ELIGIBILITY LIMIT OF \$31,152 WITH TWO OR MORE DEPENDENTS (PERCENT)</b> <sup>219</sup>	<b>2000 TOTAL RETURNS FILED FOR ALL LEVELS OF INCOME (PERCENT)</b>
Paid Prepared	57.4	34.2	29.9	45.4
Self-prepared	41.0	64.4	68.8	53.5
TAC Prepared	0.3	0.6	0.3	0.3
VITA Prepared	0.5	0.5	0.7	0.5
TCE Prepared	0.7	0.4	0.2	0.4
Total	100.0	100.0	100.0	100.0

#### E-Z Tax Filing:

The Secretary of the Treasury has announced that 78 million taxpayers will have access to free tax return preparation by the 2003 filing season.<sup>220</sup> This proposed agreement is supported by a group of private sector companies working together to offer free online filing services. The responses received about this proposal were posted in the Federal Register on August 4, 2002. They indicated approval from the segment of the population that is at ease with technology and knowledgeable about tax laws. However, this initiative would not reach low-income taxpayers who lack access to or knowledge of this technology. These taxpayers are also less familiar with the law, and consequently require the services of a tax professional or IRS (TAC, VITA or TCE) to ensure that they receive all available credits and deductions.<sup>221</sup> A 1999 IRS study on the traffic at IRS “walk-in” sites concluded that only 31 percent of taxpayers seeking return preparation services had internet access.<sup>222</sup>

<sup>216</sup> The total data figures were stratified to provide the potential number of individuals that meet the income and/or exemption levels for earned income credit for the 2000 U.S. Federal Income Tax Return. The actual number of individuals that qualified for earned income credit will vary. Tax Year 2000, Compliance Research Information System (CRIS), Model IFM 2001.

<sup>217</sup> \$10,380 is the 2000 income eligibility limit for the childless taxpayer claiming EITC. Field Assistance Operational Procedures for Fiscal Year 2000.

<sup>218</sup> \$27,413 is the 2000 income eligibility limit for the childless taxpayer claiming EITC. Field Assistance Operational Procedures for Fiscal Year 2000.

<sup>219</sup> \$31,152 is the 2000 income eligibility limit for the childless taxpayer claiming EITC. Field Assistance Operational Procedures for Fiscal Year 2000.

<sup>220</sup> *Federal Register Notice on Free Internet Filing*, *Federal Register*, Volume 67, No 153, August 8, 2002, (FR Doc 02-19835 Filed 8-5-02)

<sup>221</sup> *Responses to Federal Register Notice on Free Internet Filing Agreement (i.e., EZ Tax Filing Initiative)*, Internal Revenue Service, Electronic Tax Administration, September 17, 2002.

<sup>222</sup> North Florida, Brooklyn, Central California, Houston, and North Central District Offices Research and Analysis (DORA), *Walk-In Taxpayer Demographic and Attitudinal Profile*, April 2000.

### IRS COMMENTS

We concur that access to free income tax return preparation is a serious issue facing taxpayers. Our Stakeholder Partnership, Education & Communication (SPEC) organization has been and will continue to be proactive in identifying locations where the maximum number of eligible taxpayers (*taxpayers with low or limited incomes, taxpayers for whom English is their second language, elderly taxpayers, and individuals with disabilities*) can have access to free tax return preparation services.

In the Field Assistance (FA) organization, providing face-to-face assistance to customers with notice and account problems is a primary function; however, to the extent resources permit, needs-based return preparation service is provided. The development of a needs-based income criteria for free return preparation was done to help focus limited resources on that taxpayer segment most in need of these services. The income criterion for free preparation corresponds to the income level for Earned Income Tax Credit (EITC) eligibility or \$35,000 (for Fiscal Year 2003). In addition to the income criteria there are also form and schedule limitations for free preparation. It should be noted that although return preparation represents 11 percent of the services provided in Taxpayer Assistance Centers (TACs), it has historically required 25 percent of the total resources. Return preparation has been a cross divisional effort with a significant portion of the resources needed coming from Small Business and Self-Employed (SB/SE) Division which diverted personnel from critical Compliance functions whose primary mission is to audit returns and collect delinquent accounts. Establishing criteria to qualify for return preparation allows us to continue providing free income tax return preparation to those most in need, while not impacting other priorities.

### IRS INITIATIVES TO RESOLVE PROBLEM

- ◆ During the past two years, IRS has worked diligently to co-locate VITA sites in close proximity to TACs. During the 2002 filing season, we operated 179 co-located Volunteer Income Tax Assistance (VITA) sites allowing more flexibility to low-income taxpayers (for example, if the waiting lines are long at the TAC, they have the option of walking to the VITA site). This redirection of traffic permits Field Assistance to utilize their limited resources to resolve account problems, while still giving low-income taxpayers the options for free tax return preparation.
- ◆ In the past, VITA sites were established without any clear business rationale other than an organization such as a church, a community center, a library, or a shopping mall offering free space to establish a VITA site. IRS supported VITA through a direct business model. In effect, IRS recruited volunteers, trained volunteers,



managed the site, provided computers and e-filing software, and served as the primary technical resource for the volunteers. However, based on their resource needs, many VITA sites required substantial support from Compliance personnel. In addition, the expectations for many of these VITA sites did not materialize with some preparing less than 50 returns during a filing season, even though the IRS was investing critical resources in both staffing and equipment to support the site.

For the last few years, we have attempted to migrate from the direct business model to a leveraged business model. We now concentrate on establishing partnerships with external partners to provide education and free tax return preparation. These external partners include local governments such as mayors' offices, non-profit organizations such as United Way and the Annie Casey Foundation, Low Income Tax Clinics, private for-profit business organizations, and other community coalitions that are interested in raising the standard of living for low income citizens. These partnerships focus on education, tax assistance, and asset building strategies. They strive to ensure that low income citizens have access to free tax return preparation and have adequate information to take advantage of:

- 1) refundable tax credits such as EITC and child tax credits and,
- 2) asset building strategies such as Individual Development Accounts (IDAs) and checking/savings accounts.

Through these external partnerships, we are focusing the limited IRS resources on providing information-based support, and encouraging the community partners to provide resources such as volunteers, space, computer equipment, etc. This strategy allows the IRS to expand access to low income taxpayers and provide greater free tax return preparation than was possible under the direct business model. Within the next two to three years, this partner-focused business model should provide multiple options to shift tax return preparation away from TACs to the VITA program. Using this approach, community partner coalitions will provide much more comprehensive and sustainable programs to low income taxpayers than IRS resources could support alone.

- ◆ The income and schedule criteria used to qualify for free return preparation are clearly aimed at providing services to low income customers. At this time the data is not available to quantify the number of low income taxpayers who received free preparation or who were unable to receive needed free preparation services. In response to the need to gather this type of data, a research study is planned for fiscal year 2003. This study will allow us to determine the type of customers who use our preparation services and the reasons for needing these services. This type of



data will aid us in better defining customer needs and in planning both TAC services and alternative services such as those offered at VITA/TCE sites, the IRS Website, Low Income Taxpayer Clinics and local and national practitioner referral services.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*We commend the leadership in Wage and Investment for their desire to improve Stakeholder Partnership, Education & Communication (SPEC). SPEC has been given a new direction in assisting disadvantaged individuals with their tax obligations, especially the low income taxpayers. This effort is on the right track, and as the IRS stated, in two to three years low income taxpayers will have many more viable options to receive free tax preparation*

*However, we remain concerned about the immediate service cuts in Taxpayer Assistance Centers (TACs). In offices such as Hartford, Connecticut and Seattle, Washington, the number of taxpayers requesting assistance was so extensive that many had to be turned away. Based on the inability of SPEC to absorb the overflow from TAC, we do not recommend that Operations reduce services provided in all TAC offices at this time. We encourage the leadership to reevaluate this and to retain services at those TACs where it has clearly been demonstrated that SPEC and VITA cannot yet adequately meet the demand.*

*Even with the services available, just over one percent of all taxpayers were able to avail themselves of free services for their 1999 and 2000 returns, and the majority of those services came from VITA and TCE. It is clear that TACs alone will not make up this gap in services. The National Taxpayer Advocate recommends that Congress authorize and appropriate funding for a grant program, modeled after the Low Income Taxpayer Clinic program, for community-based coalitions to provide low income taxpayers not only with free tax preparation but also with education about and opportunities to bank and save their tax refunds. (See discussion in Preface, herein.)*



## PROBLEM

TOPIC #14

### ACCESS TO ACS (AUTOMATED COLLECTION SYSTEM)

#### IRS RESPONSIBLE OFFICIALS

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

John Dalrymple – Commissioner, Wage and Investment Division

#### DEFINITION OF PROBLEM

The IRS Automated Collection System (ACS) is generally the second step in the IRS compliance process. Accounts are assigned to ACS when the IRS does not receive a response to initial balance due or delinquent return notices. If unable to contact or come to an agreement with the taxpayer, ACS may use enforced collection actions such as filing federal tax liens or levying sources of income.

Given the possibility of such actions, it is critical that taxpayers be able to contact ACS. In FY 2002, approximately 1.7 million of the 4.2 million calls to ACS did not reach an IRS employee.<sup>223</sup>

#### ANALYSIS OF PROBLEM

Automated Collection System case processing requires employees to make telephone calls, send notices and take enforcement actions. Program imbalances occur when too few employees are available to answer the incoming calls generated by processing cases. In FY 2001, taxpayers reached an ACS employee 80 percent of the time. However, in FY 2002 this rate, known as the Customer Service Representative (CSR) Level of Service, fell to 68 percent.<sup>224</sup>

This 15 percent decrease occurred because ACS employees were not able to handle the calls generated by an increased workload. Total ACS phone calls received in FY 2002 increased by 743,000.<sup>225</sup> This growth could not be anticipated, causing the decrease in level of service. The “business measures” reports for the next fiscal year do not estimate the number of phone calls expected. Instead they reflect the number of cases the operation expects to close.

Closure goals have been set for FY 2003 at 1.4 million, a 27 percent increase from FY 2002 performance.<sup>226</sup> See table 1.14.1 below. Although the CSR Level of Service goal has been reduced to an average of 76.50 percent from the FY 2001 performance level of 80.42

<sup>223</sup> Weekly Enterprise Snapshot Report, Week Ending 9/30/2002: FY 2002 Net attempts = 4,197,671. FY 2002 Calls answered = 2,541,745

<sup>224</sup> Snapshot Report: ACS CSR Level of Service = 68.19 percent for FY 2002. 80.42 percent for FY 2001.

<sup>225</sup> Snapshot Report: FY 2002 Net Attempts (4,197,671) - FY 2001 Net attempts (3,454,595).

<sup>226</sup> Data provided by operating divisions. Figure represents the sum of closures for both SB/SE and W&I operating divisions.

percent, the total Full Time Equivalent (FTEs) would decrease by two percent.<sup>227</sup> These goals would require remarkable program efficiency.

**TABLE 1.14.1**  
**ACS CLOSURES & SERVICE**

FISCAL YEAR	2001 (ACTUAL)	2002 (ACTUAL)	2003 (PROJECTED)
ACS Closures	1.3 million	1.1 million	1.4 million
ACS FTE	2,633	2,706	2,655
CSR Level of Service	80.42%	68.19%	76.50%

\*FTE: Full Time Equivalent (Staffing measure)<sup>228</sup>

In FY 2002, almost one third of taxpayer efforts to reach the ACS call site were unsuccessful.<sup>229</sup> Increasing production goals while maintaining a reduced level of service could impose a greater burden on taxpayers who must repeatedly call ACS to get their problems resolved. If they are unable to get through, they face dire and possibly needless consequences.

#### IRS COMMENTS

We agree that taxpayer access to ACS employees to resolve delinquent accounts is a very important issue and we continue to focus on both process and systemic improvements to provide better access and service. However, we disagree with the assumption that there is a direct correlation in a decline in Level of Service (LOS) with projected increases in case closures. Projected increases in case closures reflect the Service's expectation to achieve productivity gains through training and better prioritization of cases to be worked. We do not agree that an increased closure goal automatically precludes providing adequate taxpayer access.

Several factors impacted LOS in FY 2002. Introduction of new work to the ACS environment without a corresponding increase in resources made it very difficult to balance competing workload demands. In accordance with the 1997 enactment of the Federal Debt Collection Act, IRS implemented the Federal Payment Levy Program (FPLP) using the Treasury Offset Program developed by the Financial Management Service. To date 18 of 42 federal agencies are participating in FPLP. In FY 2002, this program resulted in the issuance of more than 600,000 additional notices that included the ACS phone number (more than 250,000 notices issued by the Social Security Administration alone). More fed-

<sup>227</sup> Data provided by operating divisions.

<sup>228</sup> Data provided by operating divisions. Snapshot Report: FY 2002 - CSR Level of Service for FY 2001 and FY 2002.

<sup>229</sup> Snapshot Report: ACS CSR Level of Service = 68.19 percent for FY 2002. 80.42 percent for FY 2001.



eral agencies are scheduled to issue notices as part of the FPLP program in FY 2003. In addition, the State Income Tax Levy Program (SITLP) expanded in FY 2002 by adding eight additional states. A total of 81,000 notices were issued that included the ACS phone number. Twenty new states plus the District of Columbia will be added to the SITLP program by the end of calendar year 2003. This increase in new workload (not IRS initiated) without a corresponding increase in resources is a major challenge to meeting taxpayer access needs.

Also in FY 2002, the IRS continued implementation of the Service Center Transition plan, a key component of the modernization effort. As part of this transition plan, the workload of four sites previously dedicated to ACS calls was changed to handle calls on the general taxpayer toll-free lines. As a result, new Customer Service Representatives (CSRs) had to be hired and trained in the remaining ACS locations to pick up the additional ACS traffic. While this restructuring effort did impact ACS productivity in the short term, in the long-term the agency will reap customer service benefits to both general toll-free operations and ACS operations.

Another factor affecting ACS access in FY 2002 was the full implementation of the Enterprise Call Routing (ECR) for non-business taxpayer inquiries and Tele-center Workforce Management System (TCWMS) technology. While ECR expanded the ability to route phone calls corporately to maximize available staffing, there was a significant learning curve for using TCWMS to forecast and schedule the workload. The complexity of the workload planning process for ACS is greatly complicated by the multi-faceted nature of the work. ACS is responsible for handling inbound calls, making outbound calls and working inventory.

ACS efficiency on an enterprise-wide basis also continues to be affected by non-ACS work. Calls made from taxpayers whose cases are in the collection queue as well as calls from taxpayers with cases in other functions are directed to ACS. A study conducted by the Collection Reengineering Team indicates that 25 percent of calls received in ACS are “non ACS” calls. This phenomenon makes it very difficult to accurately forecast call levels. Without an accurate forecasting of calls, it is difficult to ensure that adequate staffing is provided to handle incoming calls. ACS could achieve a higher level of service by transferring these taxpayers to other functions, but generally this would provide a lower level of customer service and therefore, ACS handles these calls.

Recent studies of ACS incoming calls and inventory levels have found that 42 percent of ACS callers call two or more times (22 percent call two times, nine percent call three times, five percent call four times, three percent call five times and three percent call more

than five times). It appears that this pattern of multiple calls is largely a result of ACS focusing the majority of its resources on taking incoming calls while delaying resolution of cases already in inventory. There are indications that by devoting more resources to resolving inventory by closing cases, the number of taxpayers calling multiple times can be reduced and the LOS can also be improved in the long-term. In an effort to reduce the number of multiple incoming calls, more resources will be used to work ACS inventory. The LOS target is being reduced to reflect the actual level of service that ACS has been able to achieve while also incorporating an improvement factor.

#### IRS INITIATIVES TO RESOLVE PROBLEM

The IRS recognizes the need to improve the ACS operations. Without additional resources, improvement is only possible by optimizing the use of technology and available resources. The following actions are being taken to identify opportunities for process/system improvement:

- ◆ The case flow in the telephone and inventory systems is being analyzed to develop improved ACS management processes. For example, a new workload planning tool will be developed to enhance the ability to forecast ACS call volume based on outgoing notice projections. This new planning tool, in conjunction with enhanced workforce management tools, should improve the ability to assign available staffing based on workload demand.
- ◆ New easy-to-use procedural guidelines and training are being developed to enhance customer interactions.
- ◆ An “inventory day” program is being instituted that will allow site personnel to address priority inventories. By addressing these inventories, fewer taxpayers will need to make incoming calls or need to make multiple calls to resolve their cases. Calls will be routed to other sites on “inventory days” to allow for this emphasis on inventory priorities.
- ◆ An adherence standard and a workforce management tool are being provided to ACS management. The adherence standard requires each call site to provide a specified number of CSRs to take incoming calls, while the workforce management tool (TCWMS) will provide each ACS manager with the ability to know exactly what resources are available to apply to either inventory or phone calls.
- ◆ Practitioner hotlines will continue to provide practitioners with another avenue of access to resolve taxpayer problems.



**TAXPAYER ADVOCATE SERVICE COMMENTS**

*The Automated Collection System has not been listed among the top 20 problems for taxpayers since the FY 1999 National Taxpayer Advocate Report to Congress. Many previous complaints were reduced by the implementation of RRA 98 requirements and other operational changes. For example, the IRS has increased its efforts to notify taxpayers of Collection Due Process provisions and to make filing or payment arrangements before resorting to enforced collection actions. The IRS also has safeguards to prevent levies from being issued without taxpayers being notified.*

*We are pleased to note that overall customer satisfaction ratings for ACS, though falling, still stand between the neutral and “completely satisfied” range. We acknowledge the steps the IRS has taken to make ACS more efficient and to better forecast staffing needs for phone centers. We accept that the transition to a more streamlined operating structure might temporarily detract from standard performance levels.*

*ACS has returned to the list of most serious issues facing taxpayers because the dramatic decrease in CSR Level of Service presents serious concerns for taxpayers who have been notified they may face a lien or levy if contact is not made. In a more stable work environment, enhanced productivity would likely translate into improved customer access, and the coming year would show substantial gains in the level of service. However, as demonstrated in the response above, the ACS workload is not stable.*

*The IRS identified several factors that contributed to the FY 2002 decline in the CSR Level of Service. One primary cause was an increased workload from Federal (FPLP) and state (SITLP) debt collection programs described by the IRS as “non-ACS” work. While ACS does not control the flow of notices from either source, all FPLP and SITLP notices bear the ACS telephone number. The IRS attempted to minimize the impact of this additional work by handling fewer ACS inventory cases in FY 2002 as indicated in Table 1.14.1. In spite of those efforts the CSR Level of Service still declined substantially. This demonstrates the potential for continued access problems if the workload and resulting telephone demand continue to grow without resources to support that growth.*

*For FY 2003, the IRS anticipates substantial increases in both internally controlled case activity and externally driven FPLP and SITLP collection activity. The number of attempted calls by taxpayers will undoubtedly climb. The question remains whether the existing ACS resources can possibly deliver such an aggressive work plan while also improving the CSR Level of Service.*

*We conclude that relying on a hoped for efficiency level is not sufficient to protect taxpayers from hardship. The IRS should implement several additional approaches. First, FPLP and SITLP programs should be provided with a separate toll-free number to help track the workload that is “not IRS initiated.” This information can be used to demonstrate to Congress the need for additional resources to administer these programs. Second, ACS must have the ability to influence the timing and distri-*

*bution of FPLP and SITLP notices, which combine to generate 25 percent of telephone demand. Further, Congress and the administration should strongly consider allocating additional resources to support the demand of the FPLP and SITLP.*

*Total ACS staffing has decreased slightly over the past several years and was not adjusted for the additional requirements of FPLP and SITLP. Overall ACS staffing for FY 2002 stood at approximately 2700 employees or Full Time Equivalents (FTEs), with “new” employees hired only to replace losses from the consolidation of sites. Additional employees (FTEs) may be added in FY 2004 only if the Staffing Tax Administration for Balance and Equity (STABLE) initiative is fully funded.*

*The alternatives, in the absence of these changes, are either subjugation of ACS inventory work to the increased demands of the FPLP program and “non-ACS” telephone traffic or continued reduction of service to taxpayers. As the collection of taxes and other liabilities is given renewed priority, it is imperative that taxpayers facing collection action must have access to the IRS.*



## PROBLEM

TOPIC #15

### COLLECTION DUE PROCESS (CDP)

#### IRS RESPONSIBLE OFFICIAL

David Robison – Chief, IRS Appeals

#### DEFINITION OF PROBLEM

Taxpayers experience delays in receiving determinations on their Collection Due Process (CDP) cases.

#### ANALYSIS OF PROBLEM

The IRS Restructuring and Reform Act of 1998 provides taxpayers an opportunity for an independent review of a lien filed by the IRS or a proposed levy action.<sup>230</sup> This law established the Collection Due Process (CDP) hearing, which is held by an impartial officer from the Appeals unit of the IRS.<sup>231</sup> A CDP hearing is informal and can be conducted face-to-face, by telephone or by correspondence.<sup>232</sup>

The process begins when the IRS mails a certified notice to the taxpayer.<sup>233</sup> To schedule a hearing, the taxpayer returns a signed, written request within 30 days to preserve their right to a judiciary appeal of the decision.<sup>234</sup> If the request is not received timely, a hearing will be allowed but the right to a court appeal is lost. Further details of the process can be found in the Most Litigated Issues section of this report.

The receipt of CDP cases has steadily increased since the program began on January 19, 1999:<sup>235</sup>

**TABLE 1.15.1**  
**CDP RECEIPTS**

12-MONTH PERIOD ENDING	CDP CASE RECEIPTS
9/30/2000	6,892
9/30/2001	19,119
9/30/2002	26,666

<sup>230</sup> Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, Section 3401.

<sup>231</sup> IRC §§ 6330(b)(1) and 6330(b)(3).

<sup>232</sup> Treas. Reg. § 301.6330-1(d)(2), Q&A-D7.

<sup>233</sup> IRC § 6320(a)(2)(C) and IRC § 6330(a)(2)(C). The notice regarding a lien filing is sent after the lien is filed; it is required to be sent not more than five days after the day of the filing of the notice of lien. The notice regarding a levy is sent prior to the levy action; it is required to be sent not less than 30 days before the day of the first levy.

<sup>234</sup> Treas. Reg. § 301.6330-1(c)(2), Q&A-C1, C3.

<sup>235</sup> Diagnostics and Balanced Appeals Measures Report System for ACDS, IRS Appeals Due Process Workload & Cycle Time Report, FY 2002, Cumulative Through 9/30/02.



The IRS was not prepared for the influx of CDP cases. It has taken steps to address this problem by:

- ◆ Hiring more Settlement Officers;<sup>236</sup>
- ◆ Conducting collection training for employees of the Appeals division who have no collection experience;
- ◆ Implementing eight initiatives from Appeals' strategic plan for fiscal years 2002/2003 to reduce the processing time of CDP cases by 25 percent;<sup>237</sup>
- ◆ Implementing the Collection Due Process Tracking System; and
- ◆ Creating a new CDP screener position.<sup>238</sup>

Although the inventory is currently declining, increasing lien and levy activities could change that trend. The table below outlines the monthly CDP case inventory for the fiscal year ending September 30, 2002.<sup>239</sup>

**TABLE 1.15.2**  
**CDP CASE INVENTORIES**

MONTH	CDP CASE INVENTORY	SUSPENDED CASES <sup>240</sup>
October 2001	19,087	2,036
November 2001	20,531	2,314
December 2001	19,840	2,474
January 2002	20,145	2,776
February 2002	19,965	3,319
March 2002	20,076	3,872
April 2002	19,942	4,317
May 2002	19,188	4,147
June 2002	18,654	4,024
July 2002	18,129	3,615
August 2002	17,474	3,624
September 2002	17,060	3,484

<sup>236</sup> According to Appeals management, as of October 1, 2002, Appeals has hired over 100 Settlement Officers, for 232 nationwide.

<sup>237</sup> Appeals Strategy/Program Plan – FY2002/2003, Major Strategies, p. 2. The initiatives are (1) implement CDP Task Force recommendations, (2) enhance CDP Intranet website, (3) begin CDP Program Review process, (4) develop CDP case management and best practices guide, (5) streamline CDP case write-up procedures, (6) continue comprehensive CDP training program, (7) continue to streamline procedures and evaluate effectiveness of procedures between Operating Units and Appeals, and (8) increase cross-functional cooperation through transfer of knowledge regarding workload trend [*sic*] and sharing of concerns.

<sup>238</sup> According to Appeals management, as of October 1, 2002, Appeals has hired 25 of 36 CDP screeners.

<sup>239</sup> Current CCI [Collection Currency Initiative] - September 2002 Receipts, Disposals, and Inventory (Oct. – Sept. Act.).

<sup>240</sup> Current CCI [Collection Currency Initiative] – September 2002 Receipts, Disposals, and Inventory (Oct. – Sept. Act.), and IRM 8.7.2.3.9(9), (10), (11), and (12). Suspended cases are those cases where Appeals has issued a determination letter. Appeals holds the case open to determine if the taxpayer has petitioned the court for judicial review. This can take up to 180 days. The CDP Case Inventory figures above include these suspended cases.



The IRS, practitioners, and commentators have identified several concerns that lead to misuse, delays, or confusion about the CDP process:

- ◆ One commentator has noted that:

The regulations provide that a taxpayer seeking judicial review of IRS determinations at the hearing can raise only issues considered at the CDP hearing. To preserve rights of review, taxpayers should ensure that all claims or issues that it wishes the AO [Appeals Officer] to consider are stated in writing, either on the Form 12153 requesting the hearing or in a subsequent writing. Form 12153 is incomplete in that it does not provide a checklist for the types of issues that Appeals could consider; rather, it provides a blank space for taxpayers to explain why she does not agree with the proposed collection action. For a taxpayer who is unaware of what issues the AO could consider at the CDP hearing, this could prevent the taxpayer from fully exercising her rights. The IRS should modify the form to allow a taxpayer to easily identify issues she wishes for Appeals to consider.<sup>241</sup>

- ◆ Taxpayers requesting a CDP hearing are often unclear about what issues they may raise. This confusion can result in delays and the loss of judicial review of important issues.
- ◆ Taxpayers submitting a CDP request from outside the United States do not have additional time to respond, although the IRS often grants extra time for those outside the country to file other documents or respond to inquiries where important procedural rights are involved:

**TABLE 1.15.3**  
**EXTRA TIME ALLOWED FOR FILING OTHER IRS DOCUMENTS**

TITLE OF DOCUMENT	ADDITIONAL TIME ALLOWED
Notice of Deficiency	60 days <sup>242</sup>
Proposed Trust Fund Recovery Penalty Assessment Letter	30 days <sup>243</sup>
US Individual Income Tax Return	2 months <sup>244</sup>

<sup>241</sup> Leslie Book, *The New Collection Due Process Taxpayer Rights*, Tax Notes, Feb. 21, 2000, p. 1127.

<sup>242</sup> IRC § 6213(a).

<sup>243</sup> IRM 5.7.6.3(2).

<sup>244</sup> IRS Publication 17, *Your Federal Income Tax*, for use in preparing 2001 returns.

- ◆ An IRS research report issued in June 2001 revealed that 56.8 percent of businesses owing payroll taxes and seeking CDP hearings incurred additional delinquent payroll taxes after requesting the hearings.<sup>245</sup>
- ◆ The IRS is concerned about frivolous issue submissions and the misuse of CDP to delay collection action. Former Commissioner Charles Rossotti expressed this concern in testimony to Congress on May 14, 2002:

Some individuals are using the hearing process to delay collection action by filing hearing requests that raise frivolous issues....IRS Appeals has approximately 20,000 CDP cases in inventory. About four percent, or 800 cases, involve frivolous issues taxpayers...However, the numbers alone do not account for the inordinate amount of time it takes for such cases. Frivolous claims occupy a disproportionate share of time over claims from taxpayers having substantive issues. Frivolous issue taxpayers frequently file voluminous claims. Just reading these to ensure any valid issues presented are addressed is extremely time-consuming. A larger percentage of the frivolous issue taxpayers go to court where they raise the same frivolous issues. Also, some of these individuals file Sec. 1203 actions (mandatory employee termination violations) against IRS employees, which are very time-consuming, even when they are not sustained.<sup>246</sup>

Proposed legislation would increase the penalty for frivolous submissions, as is explained in the Most Litigated Issues section of this report.

### IRS COMMENTS

While Section 3401 of the Restructuring and Reform Act of 1998 (RRA98) created additional protection for taxpayers it also added major new responsibilities to the IRS. These additional duties placed significant demands on IRS' personnel resources and required Appeals to organizationally regear in a relatively short period of time in order to implement CDP.

As noted below, Appeals met the array of challenges and successfully implemented a sound CDP program. Over 100 new Settlement Officers were hired and trained along with 25 CDP screeners to work the unexpectedly large CDP inventories. These actions along with process improvements started to show results in the second half of FY 2002 as the numbers of case closures significantly increased while case aging decreased.

<sup>245</sup> *Collection Due Process: Pyramiding Trust Fund Liabilities*, IRS SB/SE Research, Brooklyn/Hartford/Philadelphia, June 2001.

<sup>246</sup> Progress Report on the IRS Restructuring and Reform Act of 1998, Hearings Before the Joint Economic Committee, 107th Congress, 2nd Sess, May 14, 2002 (statement of Commissioner of Internal Revenue Charles O. Rossotti).



## IRS INITIATIVES TO RESOLVE PROBLEM

### Delays in CDP Case Determinations

Combining process improvements with training efforts expended in fiscal year 2002 and the hiring of additional Appeals employees with collection experience, we believe that we have sufficient trained personnel to address the anticipated receipts within reasonable time frames. This is evidenced by the significant increase in the number of completed cases and reduced age of CDP inventory achieved during the second half of fiscal year 2002.

### Form 12153 Is Confusing

Appeals believes that a checklist as suggested could actually limit, rather than enhance, the number and description of issues taxpayers may wish to raise. Moreover, taxpayers are free to raise additional issues in the hearing process, other than those listed on the Form 12153. In addition, Publication 1660, Collection Appeal Rights, which explains the taxpayer's appeal rights, is mailed with all CDP notices along with Form 12153. Finally, Appeals employees are trained and provided guidance requiring that they raise any issues that the taxpayer may have failed to raise that Appeals believes would serve as an acceptable payment alternative.

### Timeframe for Filing CDP Requests

The statute does not provide the authority to alter or extend the time frame for filing a request for CDP hearing for any taxpayer. Other statutes either state a specific time frame including such extensions or allow the Secretary to prescribe procedures and timeframes as may be appropriate or reasonable. For example, IRC 6213(a) specifically provides 150 days to persons outside the U.S.A. to file a petition in response to a notice of deficiency, or 90 days for those residing in the U.S.A. IRC 6320 and 6330 specifically limit the time period to 30 days for all persons regardless of address. It is noted that when the timeframe for filing a CDP request is exceeded, the taxpayer is entitled to an equivalent hearing of the issues. The difference is that an equivalent hearing determination is not subject to judicial review.

### 56.8 Percent of Businesses Incurred Additional Payroll Liabilities

Appeals instituted a strict reporting requirement and monitoring system intended to ensure these cases are worked expeditiously. Appeals no longer holds these cases 180 days for default. Utilizing PACER, Public Access to Court Electronic Records, Appeals can now return cases to Compliance as early as 45 days after issuance of the determination letter where the taxpayer has not timely requested judicial review.

**Frivolous Submissions**

We concur that frivolous submissions require a disproportionate amount of time to work over those cases with substantive issues. The IRS strongly supports the legislative proposals currently being considered by Congress to effectively reduce these frivolous claims and still ensure that all taxpayers are provided with the rights intended under the statute.

**TAXPAYER ADVOCATE SERVICE COMMENTS**

*We commend Appeals for taking steps to address the CDP problems facing taxpayers. We are pleased with the initiatives implemented by Appeals, particularly the hiring of additional Settlement Officers, and the creation of CDP Screener positions.*

*The Taxpayer Advocate Service plans to continue studying the Collection Due Process program and participate with the functions to improve the process as problems arise. TAS has established an advocacy team to identify trends and assist with process improvements to ensure the continued protection of taxpayer rights. This team will also study the effectiveness and impact of the newly created CDP tracking system. We will also look at the IRS functions involved in CDP cases in an attempt to identify process improvements at the earliest possible stage.*

*The National Taxpayer Advocate also recommends that the IRS undertake a research project to discover why CDP cases are not resolved at earlier stages of the collection process, prior to the issuance of the CDP notice. The IRS can also obtain important information about tax administration from those cases in which the taxpayer unsuccessfully raises questions about the validity of the underlying tax liability.*



## PROBLEM

TOPIC #16

### AWARENESS AND UNDERSTANDING OF FEDERAL TAX DEPOSIT REQUIREMENTS

#### IRS RESPONSIBLE OFFICIALS

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

#### DEFINITION OF PROBLEM

The rules for making federal tax deposits are complicated and cause errors that result in additional payments by businesses in the form of penalties. The rules also increase the cost of doing business at the IRS, due to the expense of making millions of adjustments and abatements to taxpayers' accounts.

#### ANALYSIS OF PROBLEM

Taxpayers must make deposits of federal employment taxes on time, in full, and in the correct manner to avoid a penalty for failure to deposit.<sup>247</sup> In addition, as the payroll of the taxpayer's business increases, the required deposit date or method changes.

The IRS assessed approximately 3.5 million Federal Tax Deposit (FTD) penalties for a total of \$5 billion in 2001 and 4.2 million FTD penalties totalling \$5.8 billion in 2000.<sup>248</sup> For many small businesses, receiving a penalty for even one quarter, and the subsequent amount of time it takes to straighten out and correct, can consume many resources. It also leaves taxpayers feeling confused, frustrated, and "set up." These errors drain IRS resources as well.

Coupon users generate 99 percent of FTD penalties. The IRS estimates taxpayers make FTD payments with coupons 81 percent of the time instead of using the Electronic Federal Tax Payment System (EFTPS).<sup>249</sup> In calendar year (CY) 2001, the IRS issued approximately 1.2 million notices to taxpayers or their representatives for failing to correctly identify the type of tax or tax period on the coupon. The format of the coupon contributes to these types of errors, and educational materials are lacking.

For fiscal year (FY) 2001, TAS resolved 5,761 cases involving problems with the payment of FTDs or requests for FTD penalty abatements. A review of 385 TAS cases uncovered two major problems:<sup>250</sup>

- ◆ Taxpayers did not receive notice of a change in their deposit schedule; or once notified did not have enough time to make the necessary adjustments.

<sup>247</sup> IRC § 6656.

<sup>248</sup> IRS 1995 to 2001 Data Book, Publication 55B.

<sup>249</sup> Small Business/Self Employed FTD Improvement Initiative Draft, at Part IV, page 6.

<sup>250</sup> The TAS sample consisted of Major Issue Code 510, Requests involving adjustment or abatement of an FTD penalty. The sample was pulled from a population of 3,693 cases involving Form 941.

- ◆ Taxpayers have difficulty computing the deposit frequency and completing Schedule B, Employer's Record of Federal Tax Liability.

### Change in Deposit Schedule

During the fourth quarter of 2001, the IRS issued 396,859 notices informing taxpayers of a change in deposit requirements. These notices are generated over a three-week period and must be mailed no later than the first week of December.<sup>251</sup> Twenty-three percent of these taxpayers were liable for an FTD penalty in the first quarter of calendar year 2002. This could indicate that some taxpayers are not receiving the notices, are getting them too late to adjust their deposit schedules as instructed, or are disregarding or not comprehending the notices.

Legislation enacted in 1998 allows the IRS to grant relief for penalties under IRC § 6656 for untimely deposits, based on a change in deposit schedule. From January through July of 2002, the IRS sent 91,990 FTD penalty waiver notices informing the taxpayers of their deposit schedule errors. This waiver is issued after the tax return is filed and the IRS determines that the taxpayer is not following the correct deposit schedule. Because the taxpayer is not notified of the error until the middle of the following quarter (when he or she receives the waiver notice), additional penalties can accrue in intervening quarters. The waiver notices issued during January through July of 2002 increased by 19 percent over the same period in calendar year 2001.

### Deposit Frequency and Form 941, Schedule B

Monthly schedule depositors who accumulate \$100,000 or more on any day and semi-weekly schedule depositors are required to complete and attach a Schedule B to their Form 941 in lieu of the monthly schedule of deposits. The IRS uses Schedule B to determine if taxpayers have timely deposited their withholding and tax liabilities.

Problems associated with Schedule B indicate that semiweekly depositors either did not file the form as required or completed it incorrectly. Semiweekly depositors also used the monthly schedule on the Form 941, Employer's Quarterly Federal Tax Return, to report their semiweekly tax liability. One of the reasons that semiweekly depositors may not be completing the Schedule B appropriately is the lack of guidance in the Publication 15, Circular E, Employer's Tax Guide. The IRS issued 183,765 notices to taxpayers that had missing, incomplete, or illegible Schedules B in (calendar year) 2001.

When a taxpayer establishes a new business, the IRS issues a notice assigning an employer identification number or EIN. If the taxpayer indicates that he or she will have employees, the IRS will include a FTD coupon with instructions and several Social Security

<sup>251</sup> The mailing of these notices is staggered through the months of October and November with the final mailing ending during the first week of December.



Administration publications with the notice. Publication 15 is mailed separately to new businesses.

The publications, notices and CD-ROMs that explain FTD requirements can be confusing, especially to taxpayers operating new businesses. The information in the publications is difficult to follow, causing the taxpayer to back up and reread previous sections. For example, Publication 15 states on page 17 that if the accumulated tax liability is less than \$2,500, the taxpayer may pay with the return. However, page 18 states that if total taxes on Form 941 line 11 in the lookback period are \$50,000 or less, the taxpayer is a monthly depositor. This leads a taxpayer to believe that they may be a monthly depositor when their accumulated tax liability is less than \$2,500.

The IRS Small Business/Self Employed division web site provides information about FTDs.<sup>252</sup> However, the material on the site duplicates Publication 15. This does not offer taxpayers the educational material they need to better understand the FTD requirements. The IRS has produced a video on FTDs titled “The ABC’s of Federal Tax Deposits.” However, IRS does not market this video to taxpayers and uses it only in workshops.

#### IRS COMMENTS

The IRS recognizes that FTD requirements may seem complex to taxpayers and for the last few years we have increased our efforts to inform citizens of their options in making FTD payments. We will use the National Taxpayer Advocate’s observations on the clarity of the materials to improve our publications and other outreach efforts. In the following sections, we outline specific measures that we are currently implementing to serve the FTD taxpayer.

#### Change in Deposit Schedule

Taxpayers are classified as Monthly or Semi-weekly based on a look back of prior tax periods. If the taxpayer’s requirement changes, the IRS mails an information notice by the end of November, so taxpayers have the month of December to familiarize themselves with the new requirement prior to the beginning of the new tax year. A notice (CP136) is issued and includes deposit requirement information, similar to the information provided in Publication 15.

The IRS Publication 509 (Cat. No. 15013X) provides the deposit due dates for monthly depositors and a quarterly due date chart for semi-weekly depositors, as a tool for helping taxpayers meet their deposit requirements. The IRS publications and notices promote the use of the Electronic Federal Tax Payment System (EFTPS), as a means of timely deposit-

<sup>252</sup> Available at <http://www.irs.gov>.



ing taxes, with less chance of deposit misapplication. The IRS is considering revising the Form 8109, Federal Tax Deposit Coupon, as another means of helping taxpayers properly complete the required information.

### **Deposit Frequency and Form 941, Schedule B**

The IRS realizes that the rules for making deposits may be considered complex by some taxpayers despite the fact that the current Federal Tax Deposit requirements for Federal Employment Tax have been in effect since January 1, 1993, with only two changes to the *de minimis* rule. In an effort to ease potential confusion, the IRS provides information to all business taxpayers on how to file as part of the form itself. Taxpayers also have the right to request an abatement or a decrease in penalty due to reasonable cause, and the penalty is automatically waived for first time incidents.

Normally IRS publications, such as Publication 15 and Circular E, “Employer’s Tax Guide,” do not give specific instructions for completing a schedule that may become part of a tax return. The instructions for completing Schedule B (Form 941), Employer’s Record of Federal Tax Liability, are part of the schedule itself. The current Form 941 instructs the taxpayers to use and attach Schedule B if they are Semi-weekly depositors or Monthly depositors who accumulated \$100,000 or more on any day during the tax period. At this time, the IRS is working on combining the Form 941 tax return and Schedule B, making it one complete tax return document. The proposed revision will eliminate Line 17, Monthly Summary of Federal Tax Liability (under the 2002 Form 941), and move that information to Lines A, B and C on Schedule B. Having only one Federal Tax Liability schedule should decrease the number of times the return is filed with an incorrect or missing Schedule B.

Regarding the example provided for this problem, the information on pages 17 and 18 of Publication 15 is correct. As stated on page 17, any employer whose accumulated tax for the quarter is less than \$2,500 may pay the entire amount with the tax return. This is true for both Monthly and Semi-weekly depositors. However, that statement on page 17 has nothing to do with determining whether a particular taxpayer is a Monthly or a Semi-weekly depositor. That determination is based on the \$50,000 total tax threshold for the four-quarter look back analysis, as explained pages 17 and 18 of Publication 15.



## IRS INITIATIVES TO RESOLVE PROBLEMS

### Change in Deposit Schedule

The IRS is creating a Masterfile analysis that will identify all accounts that received notification of deposit frequency change from Monthly to Semi-weekly. The analysis will check for deposits posting under Semi-weekly requirements. If no deposits are located during January for a new Semi-weekly depositor, an information notice will be generated to the taxpayer explaining that it appears he or she may be following the old Monthly deposit rules rather than the new Semi-weekly schedules. This early notification should decrease the number of Federal Tax Deposit penalty assessments in the first and second quarters. SB/SE expects to implement this early intervention notice in January 2004.

### Deposit Frequency and Form 941, Schedule B

The IRS is piloting a program that offers a one-time FTD penalty refund for a business that voluntarily converts to EFTPS from Form 8109 FTD Coupons. After making timely EFTPS deposits for four consecutive quarters, the taxpayer will have their last FTD penalty abated and the credit used to pay the penalty will be refunded. Based on the results of the test, a national rollout of the project is proposed for January 2004.

In addition, we are also producing a new bilingual Employment Tax CD-ROM, which discusses all aspects of filing employment tax returns and making federal tax deposits. We expect this CD-ROM to be made available during 2003.

## TAXPAYER ADVOCATE SERVICE COMMENTS

*Although the IRS continues to expand its outreach and educational programs for businesses, taxpayers continue to receive Federal Tax Deposit penalties. The National Taxpayer Advocate recommends that the IRS hold focus groups or survey employers, practitioners and payroll agents for feedback about the current federal tax deposit requirements (including lookback period, deposit schedules, payment method.) to identify educational needs.*

*The IRS needs to revise publications, CD-ROM products and educational notices to include flow charts or matrices as tools to aid taxpayers, especially those establishing new businesses, in determining their deposit schedules. Although we recognize the technical accuracy of Publication 15, the written material needs to flow from one section to the next and instructions need to be clear and easily understood without causing the taxpayer to have to reread previous sections.*

*The IRS' Small Business/Self Employed Division web site offers taxpayers access to various CD-ROMs to assist in meeting tax requirements. We are pleased to hear that the IRS is producing a new bilingual CD-ROM to assist taxpayers with limited English proficiency, but until the current instruc-*

*tions are revised in all published materials, federal tax deposits will continue to be a problem. We recommend the IRS develop a CD-ROM and publication that exclusively target the federal tax deposit requirements. We also suggest that these products be marketed to all taxpayers and distributed to all new businesses with employees.*

*Semiweekly depositors are required to file Schedule B while monthly depositors complete line 17 (Monthly Summary of Federal Tax Liability) on the Form 941. Instructions in Publication 15 and other educational materials need to emphasize this requirement. We support the IRS' initiative to redesign the Form 941 and Schedule B and we are looking forward to seeing if the redesign decreases the amount of missing or incorrect schedules.*

*We are concerned about the number of taxpayers that continue to make their deposits under their old schedule in the second and third quarters. We are pleased to hear that IRS is planning to monitor accounts that previously received a CP136 notice to determine if they are making their deposits based on the new schedule and look forward to its implementation.*

*We applaud the IRS' efforts to increase the number of taxpayers currently using the EFTPS by offering a one-time FTD penalty refund. We are eager to see the results of the pilot program. However, since the majority of taxpayers make their deposits using the payment coupon, the National Taxpayer Advocate strongly suggests that the IRS revise the current payment coupon to minimize errors. One suggestion could be to move the position of the bubbles to the right of the text, which reflects the acceptable standard for bubble forms. Finally, the IRS needs to include instructions on how to properly complete a payment coupon in CD-ROMs and other educational materials.*



## PROBLEM

TOPIC #17

### TOLL-FREE ACCURACY

#### IRS RESPONSIBLE OFFICIALS

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

John Dalrymple – Commissioner, Wage and Investment Division

#### DEFINITION OF PROBLEM

IRS quality measures indicate that in fiscal year 2002, errors were made in approximately 20 percent of all calls to primary toll-free service lines.<sup>253</sup>

The IRS did not distinguish between the significance and severity of the various errors. For example:

- ◆ Was the answer incorrect?
- ◆ Did the employee fail to address a fact that might change the conclusion?
- ◆ Did the response exclude a reference source or form number, possibly requiring the customer to call again for that information?

The failure to report such distinctions diminishes the confidence of the taxpayer in the response received from toll-free lines. One accountant, quoted in the *Wall Street Journal*, said, “My advice is not to call the IRS if it’s something important.”<sup>254</sup>

#### ANALYSIS OF PROBLEM

The quality of IRS Toll-Free Telephone service was one of the Most Serious Problems in the National Taxpayer Advocate’s FY 2001 Report to Congress.<sup>255</sup> For the period covered by that report, the IRS achieved a 75 percent accuracy rating for tax law responses and a 69 percent rating for taxpayers’ account responses.

As noted in a recent General Accounting Office (GAO) report, the IRS has “achieved some improvements in telephone service.”<sup>256</sup> Through the end of FY 2002, tax law quality ratings improved to 81.2 percent, and ratings for account inquiries increased to 74.2 percent.<sup>257</sup>

<sup>253</sup> Weighted Accuracy Report, Fiscal Year Rollup, (as of July 2002) W&I/SBSE “Enterprise” combined rates: Tax Law – 81.1 percent; Accounts 74.3 percent.

<sup>254</sup> Tom Herman’s “Tax Report,” *The Wall Street Journal*, Sept. 5, 2002.

<sup>255</sup> National Taxpayer Advocate, *FY 2001 Annual Report to Congress*, Publication 2104 (Revision 12-2001), page 18.

<sup>256</sup> General Accounting Office, *IRS Assessment of Budget Request for Fiscal Year 2003 and Interim Results of 2002 Tax Filing Season*, page 12; GAO-02-580T.

<sup>257</sup> Weighted Accuracy Report, Fiscal Year Roll-up, as of September 21, 2002.

**TABLE 1.17.1**  
**QUALITY DATA FOR FY 2001 AND FY 2002**<sup>258</sup>

MEASURE	FY 2001	FY 2002
Tax Law Quality	74.7	81.2
Accounts Quality	69.1	74.1

Although the quality of responses has improved, accuracy will continue to be a serious problem with toll-free telephone service until taxpayers can consistently rely on IRS responses.

Part of the problem is the measurement used, which judges responses either right or completely wrong. A single mistake or omission during the call, no matter how critical to the overall response, will render the entire contact wrong. This sets a high standard for IRS employees but makes it impossible to know from the quality report the type of errors and omissions most frequently made, and where additional training is needed.

#### IRS COMMENTS

IRS continues to be committed to providing the best possible service to its customers. Improving accuracy was a major focus in planning for filing season 2002. IRS thoroughly analyzed its accuracy data to identify problems and develop action items. Initiatives included actions such as specialized training and certification during the early months of FY 2002, assigning call site managers “ownership” or accountability for specific tax law topics, and issuance of consistent review guidelines to all managers. The action items resulted in significant improvement in quality measures for FY 2002.

Although a “pass/fail” system was used to assess accuracy, IRS maintains a national database to identify top defects and detail information by telephone calls reviewed. Reports can be generated to determine the questions asked by customers and responses by customer service representatives (CSR), and why the questions were considered inaccurate.

#### IRS INITIATIVES TO RESOLVE PROBLEM

On October 1, 2002, IRS implemented an “embedded quality” (EQ) program that eliminates the “pass/fail” method for measuring quality and should rectify the problem of not distinguishing between “wrong” answers and procedural defects that do not affect the accuracy of the answer. New quality measures were defined from analysis of customer satisfaction data and feedback from employees and managers and are calculated based on

<sup>258</sup> Weighted Accuracy Report, November 2002.



defects per opportunity. The comprehensive measures include timeliness, professionalism, and accuracy with sub-components for customer accuracy, regulatory accuracy, and procedural accuracy. In addition, the new measurement system links employee performance to organizational results related to the quality of customer service. Data from the proof of concept and pilot testing were very positive and pinpointed problems and their severity.

This new measurement system will be used in our toll-free operations and other segments of the IRS during FY 2003 with plans to expand it during FY 2003 to other programs. During this transition, the IRS will maintain the old accuracy measures for FY 2003 in the functions not testing the new measurements. The results of the new system will be used as a baseline. Both the Treasury Inspector General for Tax Administration and the General Accounting Office are aware of this new approach, which we believe will be a significant step in achieving a permanent improvement in providing quality service to taxpayers.

#### **TAXPAYER ADVOCATE SERVICE COMMENTS**

*The IRS faces both real and perceived response reliability problems in the Toll-Free telephone service operations. We are pleased with the steps taken in FY 2002 and in planning for FY 2003 to address these problems.*

*As noted in the IRS comments, IRS quality review staff produced numerous system and program recommendations based on analysis of filing season errors. The challenge for the IRS will be to effectively implement the recommendations and track the impact of those efforts on 2003 filing season performance.*

*The Embedded Quality initiative has the potential to significantly bolster public confidence in IRS responses through an improved portrayal of program performance and a heightened engagement of each assistor in the quality process. Measuring employees on timeliness, professionalism, and accuracy – qualities that internal and external users identified as critical to customer satisfaction – will align IRS performance with taxpayer expectations. We are pleased to note the effort the IRS will expend in FY 2003 to capture data that will allow for comparison of current performance against prior years' measures.*

*We applaud the IRS for increasing the quality of service provided to taxpayers in FY 2002 and recognize that this success required substantial effort. For FY 2003, we anticipate continued "real" improvement and a clearer picture of the IRS as a source of reliable information and service. We will be monitoring these initiatives in FY 2003 and look forward to the time when toll-free accuracy is no longer on the National Taxpayer Advocate's list of Most Serious Problems.*

**PROBLEM**

TOPIC #18

**TOLL FREE LEVEL OF SERVICE (ACCESS)****IRS RESPONSIBLE OFFICIALS**

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

John Dalrymple – Commissioner, Wage and Investment Division

**DEFINITION OF PROBLEM**

The IRS has not clearly explained to taxpayers its strategy for providing toll-free service and the use of automated service for some inquires. Taxpayers call expecting live assistance, but 22 percent of those who reached the IRS in FY 2002 received only automated help.<sup>259</sup> This conflict between expectations and the limited availability of live assistors results in poor customer satisfaction.

The IRS has not defined specific goals for achieving what it calls “world class” customer service.

**ANALYSIS OF PROBLEM**

Access to IRS toll-free service led the National Taxpayer Advocate’s fiscal year 2001 list of the Most Serious Problems Encountered by Taxpayers.<sup>260</sup> “Access” describes the ability of callers to reach IRS assistance menus without a busy signal. The IRS has improved access. Former Commissioner Charles Rossotti stated in his *Progress Report From the Commissioner of the Internal Revenue Service* that “Nearly all callers now have almost immediate access to automated services, although some callers are forced to wait longer to receive assistor service.”<sup>261</sup> The response of the operating divisions published in the FY 2001 National Taxpayer Advocate’s Annual Report to Congress listed the access rate at 94 percent.<sup>262</sup>

The problem has now shifted to the handling of calls once the taxpayer reaches the IRS menu system. The FY2002 National Taxpayer Advocate’s Annual Report to Congress focuses on the ability of callers to connect with a Customer Service Representative (CSR) as measured by the “CSR Level of Service.”

In fiscal year 2002, the IRS achieved a CSR Level of Service of 70.24 percent.<sup>263</sup> The agency has taken many steps to maximize the likelihood that a caller can reach someone

<sup>259</sup> IRS Weekly Enterprise Snapshot Report, Enterprise Telephone Data, 9/30/2002.

<sup>260</sup> National Taxpayer Advocate, *FY 2001 Annual Report to Congress*, Publication 2104 (Revision 12-2001), page 8.

<sup>261</sup> Charles M. Rossotti, *Progress Report From the Commissioner of the Internal Revenue Service*, December 2001, page 14.

<sup>262</sup> See fn. 260.

<sup>263</sup> Weekly Enterprise Snapshot Report, Enterprise Telephone Data, 9/30/2002.



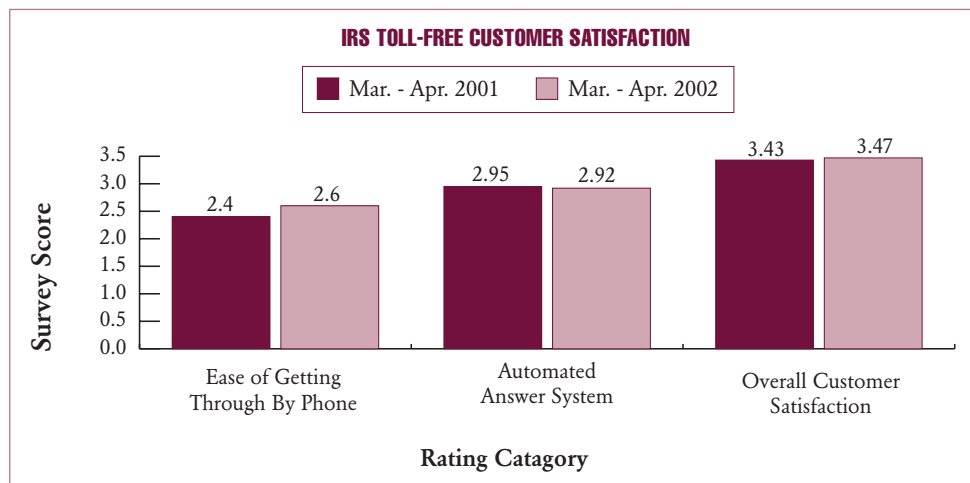
to help them with their inquiry.<sup>264</sup> Indeed, the level of service increased by 14 percent from FY 2001 to FY 2002, yet customers still report discontent with automated systems and menus.<sup>265</sup>

**TABLE 1.18.1**  
**TOLL-FREE ACCESS & SERVICE**

MEASURE	FY 2001	FY 2002
Level of Access	94%	NA <sup>266</sup>
CSR Level of Service	61.61%	70.24%

IRS Customer Satisfaction surveys continue to place “Ease of Getting Through By Phone” and “The Automated Phone System” as the aspects of IRS toll-free service that customers find least satisfactory even though they report high marks for many other aspects of service.<sup>267</sup> This graph shows the two lowest rated customer survey categories with the overall customer satisfaction rating. A zero indicates dissatisfaction while a four indicates a very satisfied response.

**TABLE 1.18.2**  
**CUSTOMER SATISFACTION**



<sup>264</sup> U.S. General Accounting Office, *Assessment of Budget Request for Fiscal Year 2003 and Interim Results of 2002 Tax Filing Season*, April 9, 2002.

<sup>265</sup> Florida Taxpayer Advocacy Panel Recommendation with letter from E. W. Gargiulo, Chairperson, to John M. Dalrymple, Commissioner, Wage and Investment Division (January 28, 2002).

<sup>266</sup> IRS no longer uses Level of Access (LOA) as an official measure. The calculation, measured at the network level, is network attempts that entered the system vs. total network attempts. E.g.: The LOA for October 1, 2002 was 99 percent of 142,268 calls. (Daily Toll-Free Detail Executive Level Summary Report).

<sup>267</sup> IRS Customer Satisfaction Survey National Report, National Toll Free: SB/SE results covering April-June 2002, Pacific Consulting Group August 2002, pages 21 & 28.



The challenge for the IRS is not only to improve service statistics with limited resources, but to determine how services can best meet the expectations of taxpayers. For example, the use of automated services noted above is designed to split off the inquiries that can be adequately handled without human interaction. Automation is a strategic tool to increase the number of callers served by a limited number of representatives.<sup>268</sup> However, if taxpayers expect or want to speak with a “live” person, they will be disappointed with automated service.

The IRS says it is committed to providing “world class” customer service.<sup>269</sup> Although the agency has studied the characteristics of such service, it has not defined specific targets. A General Accounting Office (GAO) report also notes that “there is not an industry standard service level. Each organization must determine its ... own unique circumstances.”<sup>270</sup> Service improvement numbers will not increase until customers, stakeholders, and the IRS agree on the definition of “world class” service.

#### IRS COMMENTS

In its efforts to deliver world class service, the IRS continues to make toll free telephone access one of its top priorities as reflected in its business performance measures. These measures are based on the number of services provided and the time taken to provide them. During the 2002 filing season, accessibility measures improved from the prior filing season. As stated above, a higher percentage of customers were successful reaching a customer service representative (CSR) in comparison to the past year. In addition, the overall length of time a customer waited before speaking with a CSR decreased by more than a minute. This is determined by measuring average speed of answer (ASA) that was 337 seconds and 268 seconds in 2001 and 2002, respectively. Another indicator is the percentage of customers who waited 30 seconds or less before speaking to a CSR. This measure increased 12 percentage points, from 39 percent during 2001 to 51 percent during 2002.

In addition, to simplify and make clearer the topic choices on the toll-free line, several of the announcements were eliminated or streamlined. This reduced the percentage of customers who hung-up prior to reaching a CSR by 13 points, a significant decrease.

<sup>268</sup> Letter from J. R. Watson, Director Customer Account Services (Wage and Investment Division), to John Boehm, Chairman Midwest Taxpayer Advocacy Panel (February 14, 2002).

<sup>269</sup> Charles M. Rossotti, *Progress Report From the Commissioner of the Internal Revenue Service*, page 14, December 2001.

<sup>270</sup> U.S. General Accounting Office, *Customer Service Human Capital Management at Selected Public and Private Call Centers*, GAO/GGD-00-161, August 2000.



**IRS INITIATIVES TO RESOLVE PROBLEM**

The IRS will implement the realignment of the Customer Response Toll-Free numbers effective January 1, 2003. The implementation of this initiative will enable the IRS to better serve its customer base by providing a toll-free environment that will segment customers according to their type. This will establish a clear accountability to the specific IRS operating division for the delivery of services consistent with the customer base of the operating division.

In an example of the expansion of service for specific issues, starting in December 2002, customers with business or specialty tax questions can call the new Business and Specialty Tax Line on 1-800-829-4933. Customers calling this number can apply for a new Employer Identification Number (EIN), and receive help on Employment Taxes, Partnership, Corporation, Estate, Gift, Trust and Excise Taxes, or other small business issues. This new number will enable IRS to provide better service for businesses, with a number dedicated just for them, and better service for customers with individual income tax questions by reserving the traditional 1040 help line (1-800-829-1040) for them.

The December 2002 realignment will also increase customer satisfaction by offering fewer and more focused menu choices to navigate within the separate individual and business service lines. Separating the incoming calls by individual and business issues means customers will reach CSRs specially trained in their topics, more quickly and efficiently. Customers can continue to obtain assistance with any Form 1040 issue by calling 1-800-829-1040.

The Business and Individual Tax Lines are designed to handle general inquiries. If customers receive correspondence from IRS directing them to call a different number, they should call that number to receive the quickest resolution of their specific issue. They will not be competing for service with customers seeking general assistance.

If customers need information about individual income tax refunds, and have access to the Internet, the fastest way to get assistance is through the “Where’s my Refund?” automated self-service feature, available 24 hours a day, 7 days a week at <http://www.irs.gov/>. Otherwise, customers may call the Refund Hotline at 1-800-829-1954, which is the second new toll free number IRS has established to provide more efficient service to customers.

**TAXPAYER ADVOCATE SERVICE COMMENTS**

*We applaud IRS improvements in toll-free service provided during FY 2002, and recognize that overall satisfaction is high. Surveys give high marks for employee responsiveness, politeness, courtesy, fairness, and attitude.<sup>271</sup> Beyond the changes mentioned by the IRS, a simplified script was employed during the 2002 filing season and the hours of toll-free service were shortened from 24/7 to 15/6 based on analysis of call patterns so that more staff are available during the hours when customers generally call.<sup>272</sup>*

*The IRS continues to make strides to improve service by:*

- ◆ *reducing busy signals,*
- ◆ *simplifying menus,*
- ◆ *improving call handling, and*
- ◆ *decreasing the time customers spend waiting on hold.*

*Yet customer satisfaction ratings of the “Automated Answering System” and of “Ease of Getting Through By Phone” remain in the “neutral” category, well below “completely satisfied.”<sup>273</sup> While the IRS indicates plans to improve the way customers reach assistors in FY 2003, the IRS does not discuss either the growing number of customers who will reach an electronic voice instead of an assistor, or any involvement of customers and stakeholders in developing service improvements. Successful renovation of toll-free service and improved customer satisfaction requires two elements not yet in evidence.*

*First, the IRS must work with stakeholders such as the Oversight Board, the Taxpayer Advocacy Panel (TAP), practitioners and focus groups to assess what strategies are currently acceptable and/or what changes could render a strategy acceptable. The menu system affords an example of the potential impact of such a partnership. IRS menus lack several elements found in leading private sector customer service operations. We were pleased to find that the IRS plans to add menu features for FY 2003 to allow customers to repeat a menu or return to a previous one. However, when the former Citizens Advocacy Panel (now TAP) recommended adding a menu option for live assistance, they were told the IRS avoided the practice to reduce the number of staff devoted to routing calls.<sup>274</sup> With greater interaction as a standard practice, perhaps a compromise could have satisfied the customer needs while meeting the strategic objective. We suggest the IRS state an option for live assistance when menu layers number more than two.*

<sup>271</sup> W&I Customer Satisfaction Survey, National Report; National Toll-Free Results; Pacific Consulting Group; Covering April through June 2002; SB/SE Customer Satisfaction Survey, National Report: National Toll Free Results; Pacific Consulting Group; Covering April through June 2002.

<sup>272</sup> Treasury Inspector General for Tax Administration, *Significant Efforts Have Been Made to Provide Taxpayers Better Access*, TIGTA 2003-30-001; October 2002.

<sup>273</sup> See Table 1.18.2, Customer Satisfaction.

<sup>274</sup> Letter from E. W. Gargiulo, Chairman Florida Citizen Advocacy Panel, to John Dalrymple, Commissioner Wage and Investment Operating Division, January 28, 2002 and response from J. R. Watson, Director, Customer Account Services, February 19, 2002.



*Second, the IRS needs to communicate service strategies to the public. In the case of automated services, this might be accomplished through the use of a brief preamble that advises a taxpayer why the call is being answered by automation and what options the caller will have for human contact if the automated service is not sufficient.*

*The IRS should consider conducting observational studies, in which taxpayers with actual problems are observed navigating through the phone system – automated and live assistor. Was the taxpayer satisfied? If not, when did the taxpayer begin to feel frustrated, impatient, or dissatisfied. What additional information, prompts, or assistance might have mitigated this dissatisfaction?*

*In general, the IRS efforts and rationale to improve toll-free service, while significant, have not been well communicated to the customer base. The IRS needs to reevaluate the involvement of stakeholders and taxpayers in defining acceptable quality service goals and methods.*

**PROBLEM**

TOPIC #19

**REFUND INQUIRIES****IRS RESPONSIBLE OFFICIALS**

John Dalrymple – Commissioner, Wage &amp; Investment Division

Peggy Bogadi – Acting Director, Information Systems Service Center Operations

**DEFINITION OF PROBLEM**

In fiscal year (FY) 2001, the Taxpayer Advocate Service (TAS) received 24,586 cases concerning refund inquiries. An analysis of 451 of these cases reveals two major contributing factors:<sup>275</sup>

- ◆ The IRS failed to process refund inquiries by the promised date after the taxpayers provided the missing information.
- ◆ The IRS mailed refund checks separately from notices of changes to the refunds taxpayers were expecting.

**ANALYSIS OF PROBLEM**

During fiscal year 2001, the IRS' toll-free operations provided service to 42,248,737 taxpayers, 13,084,891 of whom made refund inquiries. The toll-free function records the total volume of calls and summarizes them by category, such as tax law, refund, and accounts. However, the toll-free unit does not record specific issues within each major category, such as when the refund was mailed, how much it was for, whether the IRS received an address change, or why the refund issued differed from the amount claimed on the return. The sample of 451 TAS cases reviewed provided some insight into these underlying issues.

- ◆ Twenty-five percent of the contacts were due to missing information, forms, signatures, or incorrect addresses, and were in the control of the servicing campus (service center). The TAS referrals were taxpayer inquiries received after the taxpayer had sent the required information and IRS failed to reply by the date promised.
- ◆ Ten percent of the contacts made by taxpayers concerned undeliverable refunds. The TAS inquiries were a result of previous or repeated requests to the IRS by the taxpayer to input a change of address. Problems developed when the IRS either delayed or did not perform the input, and the refund was then returned as undeliverable.
- ◆ The remaining 65 percent were due to various reasons such as criminal investigations, injured spouse claims, refund offsets, and math errors.

<sup>275</sup> TAS Quality Sample for a population of 24,586 Major Issue Code (MI) 020 (Random sample of 451 cases reviewed) from TAMIS (Taxpayer Advocate Management System) for FY 2001



- ◆ The delay between the mailing of a refund check and notification of the change in the refund amount confuses taxpayers and generates telephone inquiries. Since IRS Operations does not capture the details of each contact, we cannot be sure how many contacts were due to inquiries about reductions or changes in the refund amount. The number was significant enough to lead Operations to develop a program that combined the refund check and the IRS notice into one mailing. This process was known as the Refund/Notice Integration Project.<sup>276</sup> However, to date this program has not been implemented due to budget constraints.

### IRS COMMENTS

The IRS agrees that timely refunds are a taxpayer priority. In addition, we concur that answering and managing refund inquiries requires considerable resources and that the root causes of these inquiries should receive increased attention and analysis. However, we do not agree that it is a problem when refunds are delayed due to criminal investigations, refund offsets, math errors, or injured spouse claims (65 percent of the refund cases reported as problems). These cases, by definition, require more careful consideration and increased time to resolve prior to release of a refund that the taxpayer may, or may not, be entitled to receive.

We agree there are opportunities to increase the accuracy and efficiency of IRS processing of refund claims. However, considerable additional analysis of the many problems cited in this report will be necessary before effective remedies to such long-standing problems as missing signature and incorrect addresses on returns could be developed.

Increased taxpayer education and outreach efforts will definitely assist in preventing taxpayer errors that contribute to delays in refunds. Also, it is agreed that the combined mailing of refunds that have been adjusted and notices explaining the adjustments is an improvement that IRS has planned for quite some time in cooperation with the Financial Management System (FMS). However, as noted in this report, funding issues are limiting progress on the Refund/Notice Integration project and additional design work is needed.

The Service is undertaking many large modernization projects and these projects require annual prioritization to best utilize limited resources. Effective submission processing operations provides the vast majority of taxpayers' seamless and timely receipt of over 92 million individual income tax refunds. The volume of subsequent inquiries received in relation to those that experience an actual delay in the refund is very small especially considering 65 percent of such contacts are attributed in this report to criminal investigation, etc. However, we do agree that reducing these contacts would enable IRS to devote more resources to responding to substantive tax law and account inquiries.

<sup>276</sup> National Taxpayer Advocate, *FY 2001 Annual Report to Congress*, Publication 2104 (Revision 12-2001), page 24.

### IRS INITIATIVES TO RESOLVE PROBLEM

The IRS continues to improve the refund inquiry process and this year offered taxpayers a significant new service. Beginning in late May 2002, taxpayers were able to check the status of their refund with a new Internet application “Where’s my refund” located on the main page of the “IRS.gov” page (formerly “The Digital Daily”). To date, 1.1 million successful requests have been processed by the system. The Service will also provide new dedicated toll free lines and automated refund services through Teletax. The Refund Inquiry function will use a new system to view negotiated refund checks in the Financial Management Services database, enabling better service to the taxpayer. IRS increases in electronic filing and refund direct deposits, are also contributing to the overall increase in refund timeliness.

### TAXPAYER ADVOCATE SERVICE COMMENTS

*The National Taxpayer Advocate shares the IRS concern about taxpayers receiving timely refunds. TAS does not concur that refund delays outside of submission processing operations are not problematic. TAS received 24,586 refund inquiries with varying issues in fiscal year 2001.<sup>277</sup> However, the underlying problem was the failure of the IRS to respond by the date promised. We welcome the IRS commitment to analyze the root causes of this longstanding problem of the refund inquiries and develop effective remedies. We also recommend that the IRS give equal consideration to the entire process.*

*The National Taxpayer Advocate recommends full, immediate implementation of the Refund/Notice Integration (R/NIP) project. This would benefit the taxpayer by providing an explanation of proposed corrections in addition to the refund check. We strongly recommend that the R/NIP project remain a priority in the IRS modernization initiative. The National Taxpayer Advocate remains concerned about the impact of withholding entire refunds while the IRS determines the taxpayers’ Earned Income Tax Credit (EITC) eligibility.*

*The National Taxpayer Advocate commends IRS newest internet innovation, the application known as “Where’s my refund.” This service will assist taxpayers with unclaimed refunds. However, a significant number of low income taxpayers still have no internet access.*

*The IRS comments that it provides the timely receipt of over 92 million individual income tax refunds. We applaud the Service’s efforts. However, we advocate that the IRS give top priority to ensuring that 1) delayed refund inquiries are resolved by the date promised, and 2) that increased emphasis be placed on modernization projects that would reduce the need for taxpayers to make subsequent or repetitive refund inquiries.*

<sup>277</sup> TAMIS database, MI codes 020 for FY 2001.



*While the ability to electronically file Form 8379, Injured Spouse Claim and Allocation, will speed the receipt of the claim, it still requires the manual computation of a refund by an IRS employee, which adds four to eight weeks to the Form 1040 processing timeframe.<sup>278</sup> The National Taxpayer Advocate recommends the computation of Form 8379 be automated, so that the entire process would be completed in the Form 1040 processing timeframe. This also will reduce taxpayer inquiries about injured spouse refunds.*

*A Systemic Advocacy project team completed a proposal to automate the computation for both the electronic and paper-filed injured spouse claims. This would eliminate any manual computations, and the taxpayer would then receive their refunds more expeditiously. The National Taxpayer Advocate welcomes partnering with the IRS in implementing the above proposal.*

*The IRS has stated that “The volume of subsequent inquiries received in relation to those that experience an actual delay in the refund is very small, especially considering 65 percent of such contacts are attributed in this report to criminal investigation, etc.” Within that 65 percent are taxpayers whose refunds are delayed because of the manually computed Form 8379, Injured Spouse Claim and Allocation; refund offsets to IRS tax and non-tax debts, such as student loans and child support; math error notices that would be abated if taxpayer information is timely processed; and criminal investigation freezes where the taxpayer’s case was already cleared and Operations failed to release the freeze. We do not think any of these cases are insignificant. In each of these cases, regardless of the underlying technical issue, the IRS failed to respond timely to the taxpayer’s concern.*

*The National Taxpayer Advocate will continue to advocate for timely response to this 65 percent of the refund inquiries. Failure to adequately respond to these inquiries creates downstream cases requiring expensive and time-consuming attention. It also creates dissatisfied, disaffected taxpayers.*

<sup>278</sup> Married Filing Jointly taxpayers, who file an individual income tax return with a refund due, may file the Form 8379, Injured Spouse Claim and Allocation. Generally, one of the spouses owes a non-federal debt, such as child support, student loans, etc. The spouse not owing the debt is called the injured spouse and may receive his/her portion of the joint overpayment based on an allocation of his/her income and refundable credits.



**PROBLEM****TOPIC #20****OBTAINING EMPLOYER IDENTIFICATION NUMBERS (EINS)****IRS RESPONSIBLE OFFICIAL**

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

Taxpayers still have difficulty obtaining Employer Identification Numbers (EINs).

**ANALYSIS OF PROBLEM**

The IRS issues approximately four million Employer Identification Numbers (EINs) every year.<sup>279</sup> For many taxpayers, securing an EIN is a crucial first step in establishing a new business or establishing an estate for a deceased person. Taxpayers who are unable to obtain EINs within specified timeframes are hindered in filing federal and state returns, setting up bank accounts or conducting other business activities.<sup>280</sup> The National Taxpayer Advocate identified the process of obtaining these numbers as a serious problem for taxpayers in the FY2001 Annual Report to Congress.<sup>281</sup> In fiscal year 2002, the IRS planned and implemented a number of improvements aimed at reducing the burden of applying for an Employer Identification Number (EIN). For example, the IRS:

- ◆ Consolidated the EIN Program into three Small Business/Self-Employed Accounts Management sites;
- ◆ Established a new toll-free number, which now allows calls to be directed to the next available assistor in any of the three locations;
- ◆ Established hours of operations as 7:30 a.m. to 5:30 p.m. in the customer's local time zone;
- ◆ Revised the Form SS-4, Application for Employer Identification Number, which now includes an embedded third party authorization;
- ◆ Installed a fax file server, which now allows the receipt of multiple faxes without burdening the taxpayer with busy signals;
- ◆ Created a team, with members selected from all three sites, to develop consistent procedures. This team must approve all new procedural changes that are developed, before they are implemented; and

<sup>279</sup> Treasury Inspector General for Tax Administration (TIGTA) Management Advisory Report, *Progress in Issuing Employer Identification Numbers Has Been Made, but Enhancements Are Needed*, Number 2002-30-182, September 2002, page 3.

<sup>280</sup> IRM 21.7.13.1.8 provides the IRS' timeframes for issuing EINs as follows:  
 a. Tele-TIN request should receive an EIN within 15 minutes.  
 b. Fax-TIN request should receive an EIN within four workdays if a return fax number is available, otherwise, see timeframe for Mail SS-4 below.  
 c. Mail in SS-4s should receive an EIN within four weeks.

<sup>281</sup> National Taxpayer Advocate, *FY 2001 Annual Report to Congress*, Publication 2104 (Revision 12-2001), page 43.



- ◆ Developed an EIN Internet application to provide taxpayers with the ability to request and receive EINs online.<sup>282</sup>

A review of IRS management inventory reports,<sup>283</sup> a recent Treasury Inspector General for Tax Administration (TIGTA) review<sup>284</sup> and an analysis of Taxpayer Advocate Service (TAS) inventory<sup>285</sup> indicate that IRS initiatives have reduced the EIN burden for taxpayers in fiscal year 2002. But while the problem has diminished, the IRS continues to receive complaints about the EIN application process from individuals as well as practitioner groups, although at a much lower rate than in prior years. The following issues still exist:

**The IRS continues to mishandle requests for EINs by third parties.** IRS employees are not identifying third party requests and not faxing the assigned EIN back to the third party requestor.

#### Example

Comments from a legal professional association: *“While the new third party designation is extremely useful in assisting our clients, the process for obtaining Employer Identification Numbers (EINs) has not been very “user friendly.” On two separate occasions, we have faxed Form SS-4, Application for Employer Identification Number, to the IRS. On both occasions, the assigned EIN was not faxed back to the fax number shown on the form (the third party designee fax number) within the IRS’ promised four days.”*<sup>286</sup>

**The IRS is not processing bulk requests for EINs expeditiously.** Internal Revenue Manual (IRM) procedures do not allow for a new block of EINs to be issued when the current block of numbers is not depleted.<sup>287</sup> Consequently, practitioners who have only a limited supply of EINs remaining may experience delays in receiving a new block. This is of particular concern to estate attorneys, who have difficulty projecting or scheduling the number of EINs they would need to request for decedents. This issue seriously affects their ability to open estate accounts in a timely fashion.

<sup>282</sup> IRS is planning an implementation date of December 2002 for this program.

<sup>283</sup> Management reports provided by SB/SE, dated 07/29/2002.

<sup>284</sup> Treasury Inspector General for Tax Administration (TIGTA) Management Advisory Report, *Progress in Issuing Employer Identification Numbers Has Been Made, but Enhancements Are Needed*, Number 2002-30-182, dated September 2002.

<sup>285</sup> The TAS sample consisted of Major Issue Codes 340—Initial Processing of Documents and 413—SS-4 Application & Entity Changes. The review of 174 cases was based on all receipts in these Major Issue codes that contained the words “SS-4 or EIN,” between March 01, 2002, and May 29, 2002.

<sup>286</sup> Letter from Michael J. Zaino, Zaino & Humphrey, A Legal Professional Association, to Joseph W. Budd, Local Taxpayer Advocate, Cincinnati Campus (Service Center.), May 1, 2002.

<sup>287</sup> IRM 21.7.13.13.2 states: Do not issue additional BULK EINs to institutions that have not yet submitted all Forms SS-4 from the last BULK request filled.

**Example**

A practitioner who requires 10 EINs to meet client needs and may have only three on hand may have to wait several weeks to receive a new block of numbers in order to issue the seven additional numbers.<sup>288</sup>

**Periodic Tele-TIN Downtime.** The IRS is not processing Tele-TIN applications received during yearly computer system (the Integrated Data Retrieval System or IDRS) downtime within promised timeframes. The yearly down time is generally the last week in December and the first few weeks of January.

**Example**

The annual shutdown of the IRS' computer system, Integrated Data Retrieval System (IDRS), coincides with the peak demand period for requests for new EINs. The current contingency plan to address IDRS downtime provides for keeping the toll-free telephone service operational and taking requests by manually completing Forms SS-4. Once IDRS is available, the tax examiner processes the Forms SS-4, issues and mails the EINs. While this ultimately yields the needed EINs, it does not meet the customer's expectation of receiving a number immediately.<sup>289</sup>

**IRS COMMENTS**

In fiscal year 2002, the IRS centralized and significantly improved its program for providing Employer Identification Numbers (EINs) to business taxpayers. We consolidated the EIN program from ten sites to three sites and, in January 2002, established a toll-free environment for requesting EINs. Initially, the demand for service far exceeded our estimates and our capacity to respond timely. However, the Small Business/Self-Employed (SB/SE) Division took immediate action to resolve these problems. We hired and trained additional assistants who were in place by the end of February 2002. Beginning in March, we achieved dramatic improvement in both paper and telephone programs. Through September 30, 2002, IRS processed 1,921,000 paper EIN requests and handled over 1,711,000 EIN telephone calls.

Despite the tremendous success of our streamlined EIN application process, we recognize that there are some continuing problems, including those cited by the National Taxpayer Advocate. We already have taken steps to address these issues as described below.

<sup>288</sup> The National Taxpayer Advocate received additional feedback at several speaking engagements during 2002 in which practitioners indicated they still experience delays in requesting blocks of Employer Identification Numbers (EINs).

<sup>289</sup> Treasury Inspector General for Tax Administration (TIGTA) Management Advisory Report, *Progress in Issuing Employer Identification Numbers Has Been Made, but Enhancements Are Needed*, Number 2002-30-182, dated September 2002, page 6.



**IRS INITIATIVES TO RESOLVE PROBLEM:**

The IRS has undertaken several initiatives to continue to improve the EIN application process. Third parties now can receive an EIN immediately by utilizing our toll-free service. We place the third party caller on hold while he or she faxes in Form 2848/8821 or Form SS-4 with the third party designee box checked. After we verify the information, the EIN is given immediately to the third party designee. If the third party chooses to use our Fax-TIN service, we verify the information on the Form SS-4 and then fax the EIN back to the customer within four business days.

Under the bulk/bank EIN program, the IRS assigns blocks of EINs to a fiduciary or any other person authorized to represent ten or more trusts or estates. This includes bankruptcy estates created under Chapters 7-11 of the U.S. Bankruptcy Code, pension/retirement trusts, and GNMA (Governmental National Mortgage Association) pool requests. During this process, the Forms SS-4 are faxed daily to the campus of record for verification and disclosure. If the entire block of EINs is not used within a 45-day timeframe, the unused numbers must be returned to the IRS. This allows us to maintain consistency and control of the numbers that we have assigned. After we receive the unused numbers from the block, we process a subsequent EIN application for a new block of numbers within 48-72 hours.

To reduce taxpayer burden during FY 2003, we are changing how the EIN Program will provide services during the yearly downtime for computer system maintenance. Taxpayers will be able to request an EIN during this period through our toll-free service (1-866-816-2065) or by faxing or mailing their Forms SS-4 to the campus that serves their state. These taxpayers will receive a provisional number that can be used for banking purposes only. Once our computer system maintenance is completed, these taxpayers will receive their permanent EINs.

**TAXPAYER ADVOCATE SERVICE COMMENTS**

*We applaud the IRS on its initiatives to further enhance the EIN Application Process and agree that taxpayer burden has been reduced in this area. The Taxpayer Advocate Service will continue to monitor the IRS' progress on this issue. Continued support is essential to ensure that the IRS has the proper tools and resources to implement the Employer Identification Number (EIN) Internet Program as planned for Fiscal Year 2003.*

*We suggest that the IRS reexamine its policy of not issuing additional bulk EINs until the user has diminished his or her current supply. The requirement to use all numbers before receiving a new block, when the customer is aware of future needs, is unacceptable. We would recommend that procedures*

*allow customers to request additional bulk numbers when their current supply is low. Additionally, we would advocate a change to Revenue Procedure 89-37 to extend the time from 45 to 90 days to use the block of numbers. This would reduce the administrative burden of issuing additional blocks and handling of unused numbers. It would also allow additional participants into the program that currently would not be able to use a block of numbers within the 45 days.*



**PROBLEM**

**TOPIC #21**

**DELAY IN RECEIVING REQUESTED DOCUMENTS**

**IRS RESPONSIBLE OFFICIAL**

John Dalrymple – Commissioner, Wage & Investment Division

**DEFINITION OF PROBLEM**

Requests for documents, copies of tax returns, audit reports, income information and account transcripts are unfilled or not processed within the prescribed timeframes.

**ANALYSIS OF PROBLEM**

Taxpayers and IRS employees who need to obtain stored tax information do not always receive requested documents or responses within the prescribed time limits.<sup>290</sup> For example, IRS employees may need stored documents to respond to taxpayer inquiries about audit reconsiderations or to process offers-in-compromise. Taxpayers may request stored documents to help in reviewing an audit report or securing a mortgage. The IRS must locate these documents among millions of paper records scattered in various offices and warehouses throughout the country. The majority of filed returns are stored in Federal Record Centers (FRCs), part of the National Archives and Retrieval Administration (NARA).<sup>291</sup> The FRCs are contractually obligated to fill all document requests within eight hours of receipt.<sup>292</sup>

An out of region request takes longest to fill.<sup>293</sup> An IRS campus (formerly service center) receiving such a request must first forward it to the campus where the document would normally be housed. The receiving campus then determines if the document is stored in its file area or whether the request must go to the local FRC. That FRC is then obligated to fill any request within eight hours of receipt and return the document or unfilled request to the local campus. The document request is ultimately routed back to the requesting campus and then back to the requester.

Requests for copies of returns from photocopy units are exempt from this eight-hour timeframe requirement. Under the contract, FRCs are required to fill these requests, including out of region requests, within five calendar days of receipt. But while FRCs are

<sup>290</sup> Internal Revenue Manual 3.30.123.13.11. Document requests are to be sorted and pulled within four workdays or six workdays during the peak-processing season within the campuses.

<sup>291</sup> Each IRS campus has its own storage schedule for returns for the current processing year based on the availability of space. For example, in the 1040 series, some campuses maintain current returns for eight weeks and others for up to one year before sending to the FRC for storage.

<sup>292</sup> Bulk requests to the FRCs take longer. The FRCs have a contractual agreement with each local IRS campus to coordinate the processing time on bulk requests.

<sup>293</sup> An out of region request is a request for a document stored in another office; for example, when an employee in Philadelphia needs a return that was processed at the Fresno Submission Processing Center.

required to retrieve documents within contractual timeframes, the entire process of requesting and receiving a document out of region can realistically take up to four weeks and often longer. There is no data collected to help management determine where delays are occurring in the process.

The IRS reorganization has also significantly affected the document retrieval process. Since the reorganization, the volume of out of region requests has increased at all campuses.<sup>294</sup> In addition, shipping documents to multiple sites, increased workloads, revised document routing procedures and space limitations at some facilities have exacerbated pre-existing document retrieval problems.

Refiling backlogs cause further difficulty, as the timeframe for refiling a document varies with the volume of refiles in the FRCs. Quality controls to prevent misfiling are minimal.<sup>295</sup> Misfiled documents and documents awaiting refiling further contribute to delays in receipt of documents (i.e., the taxpayer may be requesting a document that has not yet been refiled or is misfiled) and increase the number of unfilled requests. The inability to find these documents adversely affects not only taxpayers but also the IRS, by increasing processing time in responding to taxpayer inquiries.

Nearly one in four document photocopy requests is unfilled. The percentage of documents not found at FRCs has risen from 17.1 percent in fiscal year (FY) 1999 to 25.1 percent in FY 2001.<sup>296</sup> Unfortunately, there is no statistical data gathered nationally (other than for photocopy requests) to indicate the extent to which documents are not located. Taxpayers pay a fee when requesting a copy of a tax form and receive a refund of the fee if the IRS fails to locate the form.<sup>297</sup> The IRS refunded \$2,395,754 in photocopy fees in FY 2001 and another \$2,564,888 in FY 2000.<sup>298</sup> Although photocopy refunds have declined somewhat, the amount is still significant. The IRS does not track the reasons the fee is refunded.

As noted, IRS employees request documents for internal use to assist taxpayers and respond to inquiries. Both employees and taxpayers may unnecessarily request documents, or an employee may request an incorrect document. These conditions add cost and time to the process. The number of errors in these categories is also not tracked.

<sup>294</sup> Email response dated July 22, 2002 from Program Analyst for Wage & Investment. All ten campuses have acknowledged that the reorganization has adversely impacted their document retrieval process.

<sup>295</sup> Random checks, management reviews, or reviews conducted by Quality Review Units are just some of the different quality checks used in the campuses.

<sup>296</sup> National Photocopy Reimbursable Reports from service centers for 1999 and 2001.

<sup>297</sup> IRS charges a fee of \$23.00 per return. When a third party requests a copy of an exempt or political organization's return, there is a fee of \$1.00 for the first 100 pages and 20 cents for each additional page.

<sup>298</sup> National Photocopy Reimbursable Report from service centers for 2000.



Knowing the extent of unnecessary requests could enable the IRS to better train its employees and educate the public. This would reduce inefficiencies that frustrate taxpayers, delay responses to taxpayer inquiries and add to delays in other IRS programs (e.g. audit reconsideration).

The timeframe for securing copies of tax returns, Forms W-2, Wage and Tax Statement, and audit reports is 60 calendar days; and for obtaining return and account transcripts, seven to 10 workdays.<sup>299</sup> In February 2000, the Treasury Inspector General for Tax Administration (TIGTA) conducted reviews in the Kansas City, Memphis and Fresno campuses to improve controls over the photocopy user fees. The reviews determined that personnel in those campuses did not always adequately respond to taxpayer requests and locate returns. Management agreed with the findings and responded by ensuring that all follow up actions to secure returns would be taken and the case files would be documented. However, the number of unfilled requests continues to grow.<sup>300</sup> The IRS directs its employees to issue an interim response when they cannot meet the timeframe for processing a document request.<sup>301</sup> The number of cases referred to TAS may be an indicator that the IRS is not following that procedure.<sup>302</sup>

In addition, taxpayers are having difficulty obtaining Form W-2 information for state wages and withholding. The IRS no longer collects state income information. Taxpayers must pay to secure state data (a copy of the Form W-2, if available), or must contact the Social Security Administration (SSA) and pay the required fee.<sup>303</sup> Sometimes neither the IRS nor the SSA possesses this data.<sup>304</sup> Unavailability of this information can be a prob-

<sup>299</sup> Internal Revenue Manual 21.3.6.4.3.1 and 21.3.6.4.11.1.

<sup>300</sup> Treasury Inspector General for Tax Administration, Management Advisory Reports: *The Internal Revenue Service Should Improve Controls over Photocopy User Fees at the Kansas City Service Center*, Reference No. 2000-40-038; *The Internal Revenue Service Should Improve Controls over Photocopy User Fees at the Memphis Service Center*, Reference No. 2000-40-037; *The Internal Revenue Service Should Improve Controls over Photocopy User Fees at the Fresno Service Center*, Reference No. 2000-40-036, February 2000, at page 2.

<sup>301</sup> Internal Revenue Manual 21.2.5.4.13.4.

<sup>302</sup> There were 4,644 cases referred to TAS in FY 2001 under Major Issue Code 420, Requests for forms, publications, copies of returns and transcripts. Eighty-eight percent of the TAS cases received were comprised of requests for copies of tax returns, account transcripts and income information requests where IRS failed to respond to the taxpayer, did not process the request within the prescribed timeframe, or by the date promised.

<sup>303</sup> Internal Revenue Manual 21.2.5.4.13.16.

<sup>304</sup> The SSA collects information from Forms W-2. The Wage Information Retrieval System (WIRS) maintains data through Document Image Microfilm (DIM) and Computer Output Microfilm (COM). DIM is comprised of photographs of the Forms W-2 and Forms W-3, which include state data. COM is a listing of data that has been reformatted from a magnetic media-reporting source that does not reflect state information.



lem for taxpayers and the IRS' Fed/State Exchange Program.<sup>305</sup> Taxpayers also receive misinformation on external web sites regarding how to secure copies of Forms W-2.<sup>306</sup>

Taxpayers also incur problems in securing transcripts and income information needed on an expeditious basis. Delays can cause significant hardship for taxpayers who, for example, need the information for court proceedings, college financial aid, mortgages, interviews with the Immigration and Naturalization Service, loan approvals, social service agencies or state tax returns.

Furthermore, instructions on Form 4506, Request for Copy or Transcript of Tax Form, could more clearly describe the contents of a return transcript so that taxpayers and third party requesters can better determine when to ask for a transcript. Taxpayers may unnecessarily pay for copies of tax forms when a free return transcript would suffice. Improved guidance would also help the taxpaying public request only the information needed, speed delivery, and reduce processing costs. Free return transcripts can be obtained quickly at Taxpayer Assistance Centers (walk-in sites) or from IRS call sites.

An initiative is underway to improve customer service by offering online delivery of taxpayer transcripts through the Transcript Delivery System. We are not aware of any modernization plans for requesting paper copies of returns or other documents.

#### IRS COMMENTS/INITIATIVES TO RESOLVE PROBLEM

This problem outlines numerous issues related to delays in taxpayers receiving requested documents. Principal among these are:

- 1) IRS must locate documents among millions of paper records stored in various offices and warehouses throughout the country.
- 2) Out of region requests take longest to fill.
- 3) Re-filing backlogs are leading to further difficulty.
- 4) Taxpayers have difficulty obtaining Forms W-2 and other income information.

<sup>305</sup> The Fed/State Exchange Program shares tax information between federal and state tax authorities.

<sup>306</sup> For example, some web sites advise taxpayers to contact the IRS for copies of their Form(s) W-2 at no charge using the Form 4506. However, there is a \$23 fee for securing a copy of Form(s) W-2. Taxpayers may receive a computer printout of Form(s) W-2 information at no charge online, but they do not have state income information (see e.g. Seton Hall University, "Financial Planning/Obtaining Copies of Income Tax Returns," 2002 at <http://www.shu.edu/fataxinfo.html>).



**IRS must locate documents among millions of paper records stored in various offices and warehouses throughout the country**

IRS tax records are either stored at the 10 IRS Campus Files functions or the 14 National Archives and Record Administration (NARA) record centers. The IRS Campus Files functions and NARA headquarters can track where each year's tax records are located. These records are filed and stored in document locator number (DLN) order for ease of retrieval. The IRS/NARA Interagency Agreement (IA) requires that NARA service document requests as follows:

- ◆ Normal requests within eight (8) working hours after receipt;
- ◆ Photocopy requests within a five day period;
- ◆ Priority or special servicing requests within the same day; and
- ◆ Bulk requests (i.e., Collection Statute Extension Date (CSED) prior to the end of the fiscal year and Automated Underreporter (AUR)) within a reasonable time-frame (usually agreed upon by the AUR project area, Files function and NARA).

IRS processes and files over 200 million multiple-page tax returns each year. These returns and related documents move in and out of storage and between IRS and/or NARA facilities as part of routine IRS operations, such as examinations of returns and other compliance programs. As a result, at times returns or other documents cannot be located immediately. However, free transcripts of accounts in lieu of copies of returns will fulfill most taxpayers' needs for IRS records of income for such things as applying for college financial aid, mortgages and other loans, or completing current year returns.

**An out of region request takes longest to fill**

Since the reorganization (realignment of states among the IRS sites), the number of out of region requests has increased significantly. However, the following steps have been taken to minimize delays in routing these requests:

- ◆ A unit address listing (UAL) supporting the new organizational alignment and state mapping was developed and placed on the Submission Processing Web page.
- ◆ A programming change was made to require that the requestor input a complete mailing address on Form 4251, Document Request. This will result in filling requests more expeditiously.

In addition, a programming change will be implemented in January 2003 to print an address number, mail-out city and state on the return request form, based on the unit address list. This will assist in sorting requests and will further minimize timeframes for routing of documents between IRS campuses and NARA sites.

**Re-filing backlogs are leading to further difficulty.**

This problem affects only a few NARA record centers (approximately three of the 14), which have periodically experienced large refile backlogs. To address this problem, the following steps have been taken:

- ◆ The volume of refile returns shipped between the IRS campuses and NARA record centers are being tracked. NARA submits a weekly backlog report to IRS that includes refile volumes.
- ◆ Beginning October 1, 2002, the IRS campuses are required to submit a quarterly inventory report to IRS headquarters. This report will contain the volume of refile returns shipped to NARA.
- ◆ IRS headquarters will monitor both reports. Therefore, when it is evident that a problem exists the IRS Headquarters analyst and NARA account representative will coordinate a resolution.

W&I will be coordinating with the Advocate’s office to further explore the problems resulting from misfiled documents.

**Taxpayers are having difficulty obtaining Forms W-2 and other income information.**

The next revisions of the Request for Copy or Transcript of Tax Form, (Form 4506), are targeted for implementation before June 2003 and will include in the instructions how many years of information IRS can provide and when taxpayers must go to the Social Security Administration to obtain Form W-2 information. The form will also be revised to include the same information with regard to the availability of IRS forms and emphasize the cost saving and faster service available through securing a transcript instead of a photo copy.

The report includes a statement that *“taxpayers also incur problems in securing transcripts and income information needed on an expeditious basis.”* The IRS is not aware of any significant issues or delays in processing of transcript requests. Without additional information, IRS is unable to comment on this assertion.

**TAXPAYER ADVOCATE SERVICE COMMENTS**

*This issue continues to be a problem for taxpayers and IRS employees. In last year’s National Taxpayer Advocate Report to Congress, the IRS stated that it would assemble a study group comprised of IRS personnel and representatives from TAS and NARA to explore ways of improving the tracking and availability of returns as they are retrieved and refiled. We appreciate the IRS’ efforts to require NARA to locate documents by searching refiles when a document cannot be found. However,*



*our analysis of the document request and photocopy processes confirms the need for the establishment of this study group to identify problem areas and strengthen customer service.*

*The IRS is to be commended for working to identify trends and improve customer service by tracking the reasons for the issuance of photocopy fee refunds. However, IRS management must ensure that employees follow current procedures for processing photocopy requests that include taking follow-up actions to secure documents and initiating interim responses when appropriate.*

*The IRS needs to identify training and educational opportunities for employees and taxpayers by collecting statistical data. One option would be to solicit feedback from both internal and external customers about how to improve service in both the photocopy and Files areas.*

*The IRS is in the process of revising Form 4506. The Taxpayer Advocate Service will participate in this initiative. The NTA recommends including additional examples of when a return transcript would be sufficient, in order for the taxpayer to avoid the expense of requesting a copy of the return or the actual Form(s) W-2. We appreciate plans to include additional guidance for taxpayers requesting information from the IRS and when SSA assistance is needed to obtain W-2 information. As a cautionary note, TAS is concerned that SSA does not currently have the capability of receiving all state information on transmissions received through magnetic media from employers.*

*The National Taxpayer Advocate also recommends that the IRS clarify the instructions for line 8c on Form 4506, which states that there is no charge for requesting Form(s) W-2 information. Presently, the Form 4506 provides conflicting instructions to taxpayers on when to request Form(s) W-2 information for a fee.<sup>307</sup>*

*To modernize the photocopy request process, we recommend that the IRS develop an electronic Form 4506 and automate the photocopy process by allowing taxpayers to request documents over the internet. This could be accomplished by developing a program that would walk the taxpayer through the request process, and advise the taxpayer when a return or account transcript would be appropriate at no cost. If a fee were to be required, the taxpayer could pay online via credit card.*

*The Transcript Delivery System (TDS) allows authorized customers and IRS employees to submit a request for a transcript and to receive it on-line. We applaud the IRS for this initiative and recommend the process be expanded to include imaging returns for electronic storage. This will allow receipt of copies of returns online.*

*The IRS needs to work further with state governments to determine who is required to store state income and withholding information and to explore a more efficient method of sharing state tax data under the Fed/State Exchange Program.*

<sup>307</sup> The instructions to line 8 of the form state there is no charge for requesting Form(s) W-2 information that can be in the form of a transcript or actual Form(s) W-2. However, in the instructions for line 8c, it states that if a taxpayer needs the actual Form(s) W-2, he or she is required to request a complete copy of the return and pay the required fee.

**PROBLEM****TOPIC #22****MISAPPLIED/LOST PAYMENTS****IRS RESPONSIBLE OFFICIALS**

John Dalrymple – Commissioner, Wage & Investment Division

Joe Kehoe – Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

Payments lost or misplaced by the IRS cause additional burden on taxpayers, requiring them to substantiate their initial payments. Misapplied payments require the taxpayer to submit a copy of both the front and back of the cancelled check.

**ANALYSIS OF PROBLEM**

Once the IRS has determined that a taxpayer sent a payment and the check has not cleared the taxpayer's account, IRS considers the payment to be lost or misplaced. The taxpayer must stop payment on the previously written check and submit a Form 8546, Claim for Reimbursement of Bank Charges Incurred Due to Erroneous Service Levy or Misplaced Payment Check, to receive reimbursement of any bank fees that may have been charged.<sup>308</sup>

In a review of 289 Taxpayer Advocate Service (TAS) cases identified as having problems with payments posting, 46 cases, or 16 percent, had missing or lost payments.<sup>309</sup> TAS requested the original returns from the IRS campus' (formerly service centers) files sections to determine if the checks were still attached, and learned that those payments could not be found and were thus considered lost.<sup>310</sup> However, in two of these cases, the checks were found to be attached to the original returns that had been processed and filed.

In the same review, 88 cases, or 30 percent, involved misapplied payments. Thirty-seven percent of the misapplied payments were caused by taxpayer error, but 63 percent were due to IRS errors. The latter cases included payments applied to the wrong taxpayer's account, late posting of credit, and incorrect dates recorded with credit transfers.

Chapter 21 of the Internal Revenue Manual states that when the taxpayer reports the payment as not applied to the correct account, it becomes the taxpayer's responsibility to prove payment to the IRS.<sup>311</sup> The burden on the taxpayer includes paying all expenses required to obtain a copy of the front and back of the cancelled check.

<sup>308</sup> IRS Policy Statement P-5-39, Reimbursement of Bank Charges Due to Erroneous Levy and Service Loss or Misplacement of Taxpayer Checks.

<sup>309</sup> The quality sampling from Taxpayer Advocate Management Information System (TAMIS), Major Issue Code 210, Lost or Misapplied Payment Issues, was based on a population of 11,058 cases that included both individual & business cases from October 1, 2000 to September 30, 2001.

<sup>310</sup> IRM 21.5.7.3.4, Payment Tracers.

<sup>311</sup> IRM 21.5.7.3(2).



**IRS COMMENTS**

In fiscal year 2001, IRS processed approximately 217 million payments, and nearly all are processed without any problem. However, there are some payments that are lost or misapplied due to IRS or taxpayer error. We are always concerned when taxpayers' payments do not get properly credited to their accounts. We agree with the National Taxpayer Advocate that it is a burden for the taxpayer to obtain a copy of both sides of the cancelled check, and we attempt to take every step possible to locate the payment and rectify the problem before contacting the taxpayer. However, when all our internal efforts fail, getting a copy of the cancelled check greatly increases the likelihood that we will be able to locate the payment and have it credited to the proper account as expeditiously as possible.

The part of our Internal Revenue Manual (IRM), which deals with procedures for missing payments (IRM 21.5.7), mandates that we perform internal research before the taxpayer is contacted and asked to submit a copy of the cancelled check. It provides at least 15 different research tools to use in locating the missing payments. Unfortunately, we are not always able to locate a payment through internal research. Once the taxpayer provides us a copy of both sides of the cancelled check, we usually are able to locate the payment and apply it to the taxpayer's account. If the payment still cannot be located, the specialized Hardcore Payment Tracer Function (HPTF) takes over the case. The HPTF is composed of personnel specifically trained to find hard to locate payments. They also need a copy of the cancelled check to handle the case. Therefore, while we do not wish to overburden the taxpayer, in many cases we must request a copy of the cancelled check in order to restore the proper credit to his or her account.

It is an extremely rare situation when a "lost check" is later found with the original return, as the Advocate noted happened in two cases in the sample. When this does happen, the taxpayer may file a Form 8546, Claim for Reimbursement of Bank Charges Incurred Due to Erroneous Service Levy or Mislplaced Payment Check. This claim allows the taxpayer to recoup the expense he or she incurred due to our not identifying the check and posting the payment when the taxpayer's return was received.

**IRS INITIATIVES TO RESOLVE PROBLEM**

Due to the large volume of payments we handle each year, it is virtually impossible to ensure that the process is error free. However, we do provide annual training to all functions involved, in an effort to prevent such errors and handle expeditiously those that do occur. As a last resort, contacting the taxpayer for a copy of both sides of the cancelled check is necessary to provide a speedy resolution and properly credit the taxpayer's account.

For individual taxpayers (Form 1040 series), IRS is developing an initiative called Remittance Transaction Research (RTR) to scan payments (checks and/or vouchers) received at submission processing centers and through the lockbox process. The images will be made available nationwide through RTR. We anticipate that this initiative will alleviate the burden on many taxpayers to have to submit a copy of both sides of their cancelled check. RTR will be piloted in August 2003 and is tentatively scheduled for nationwide implementation in late 2003. Additional payments (including business return payments) will be included in future enhancements available after 2003.

#### TAXPAYER ADVOCATE SERVICE COMMENTS

*The National Taxpayer Advocate recognizes that the IRS processes a great number of payments each year. We also realize that taxpayers do not always identify where they expect the payment to be credited.*

*However, we know that for those taxpayers whose checks have been lost or misapplied, it is burdensome to obtain a copy of the cancelled check or to stop payment. The instructions on locating payments in IRM 21.5.7.3 do not clearly state what steps should be taken prior to asking the taxpayer for a copy of the check. The instructions should clarify that requesting a copy of the check is a last resort when the payment cannot be located.*

*We are extremely pleased with the development of the Remittance Transaction Research initiative and urge Congress and the IRS to ensure that this initiative is appropriately funded. The National Taxpayer Advocate believes, as does the IRS, that this technology will eliminate much of the taxpayer burden associated with lost or stolen checks.*



## FOLLOW-UP REPORT

### CLAIMS FOR RELIEF FROM JOINT AND SEVERAL LIABILITY

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#### IRS RESPONSIBLE OFFICIAL

John Dalrymple – Commissioner, Wage & Investment Division

#### DEFINITION OF PROBLEM

Taxpayer concern about the status of claims for relief from joint and several liability was among the most serious problems highlighted in the National Taxpayer Advocate’s 2001 Annual Report to Congress.<sup>312</sup> Taxpayers seeking this relief were not always told their claims had been received or kept informed of progress on their claims.<sup>313</sup> Further, taxpayers were not made aware that, even under optimal conditions, the administrative actions required by law can add as much as 165 days to the processing of a claim. The IRS did not regularly update taxpayers about delays or what was happening on individual claims.

#### FOLLOW-UP DISCUSSION

Joint and several liability issues have been a recurring problem for taxpayers, as detailed in prior National Taxpayer Advocate Reports to Congress. The IRS has made continuing progress in easing problems associated with the increased volume of claims for relief. This year, the National Taxpayer Advocate highlights the program not as a problem for taxpayers, but rather, as an IRS success story.

The Restructuring and Reform Act of 1998 (RRA98) granted considerable new rights to taxpayers and expanded others, including provisions granting relief from joint and several liability.<sup>314</sup> The additional avenues for relief under these provisions caused an unexpected flood of claims.<sup>315</sup> The IRS placed thousands of these claims in suspense, pending issuance of regulatory guidance required by statute. The complex tax law implications related to claims for joint and several liability relief further contributed to the growing backlog. Taxpayers received no word on their claims for extended periods. In some instances, the IRS did not acknowledge receipt of a claim. (These claims are commonly referred to as “innocent spouse” claims.)

Over time, the IRS succeeded in tackling the numerous challenges in programming and procedures for processing “innocent spouse” claims during a major reorganization of the agency. Notably, the implementation of the Innocent Spouse Tracking System (ISTS) was key to gaining control over inventory. The system provides valuable data for use in pro-

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<sup>312</sup> Ranked # 22.

<sup>313</sup> Claims received under provisions of Internal Revenue Code (IRC) § 6015.

<sup>314</sup> Internal Revenue Service Restructuring and Reform Act of 1998(RRA98), Public Law 105-206.

<sup>315</sup> Since the passage of RRA98, IRS has received 213,467 claim years affecting approximately 112,351 taxpayers through 9/30/2002 (includes pre-ISTS tracking inventory) Source: Innocent Spouse Tracking System (ISTS), Sept. 30, 2002.



gram improvement. A web-based decision document guides IRS examiners to make timely, consistent and accurate determinations on joint and several relief eligibility. New Integrated Data Retrieval System (IDRS) programming has been developed to speed processing and improves accuracy in separating joint accounts where relief is granted.

Furthermore, improvements in inventory control have mitigated “innocent spouse” (IS) processing problems and significantly reduced staffing needs.<sup>316</sup> Staffing at the Cincinnati Centralized Innocent Spouse Operation (CCISO) has been stabilized at 168 employees, capable of processing 50,000 closures per fiscal year.<sup>317</sup> For FY 2002, CCISO closed 49,800 claim years; 49,600 closures were projected.<sup>318</sup> Additionally, more than half of CCISO “first read” screeners have been cross-trained in separating accounts where relief has been granted. During October, November and December, while awaiting peak filing of claims in a new filing season, screeners are projected to separate and close approximately 3,000 claims.<sup>319</sup> Separation is the process of splitting liability from a joint account into two separate accounts, one for each spouse, on cases where relief is granted. Until this occurs, the innocent spouse is not completely free from liability.

Full-time equivalents (FTEs) in Small Business and Self-Employed field offices were reduced.<sup>320</sup> The Innocent Spouse Project Office (ISPO) projected a decrease to 258 field staff employees for FY 2002. However, 304 employees remain to handle the 3,964 claims years affecting approximately 2,090 taxpayers.<sup>321</sup>

The development of specialized skills in CCISO examiners and the use of the automated decision-making tool helped employees at CCISO accurately resolve most claims. In FY 2002, fewer than 1,000 claims were transferred from CCISO to field offices for processing, allowing field personnel to concentrate on reducing the backlog of older claims forwarded previously.

Other enhancements affecting IS processing have included the following:

- ◆ Transmission of initial letters to taxpayers within 30 days of receipt of the IS claim to promptly inform them of receipt. Additionally, IRS has revised the initial letter

<sup>316</sup> Total IS Full-Time Equivalents (FTEs) in FY 2000 were 887; FTEs in FY 2002 were 469. Source: Innocent Spouse Tracking System (ISTS).

<sup>317</sup> Telephonic data sharing from CCISO on 10/15/02.

<sup>318</sup> *Id.*

<sup>319</sup> As of 7/1/2002, Small Business and Self-Employed Division began sending all non-protested post assessment partial and full grant claims to CCISO for end processing. The Master file Transaction 31 (MFT 31) processing of partial and full grant IS claims has recently been moved to the Andover Wage and Investment Campus. Source: Innocent Spouse Tracking System, July 2002.

<sup>320</sup> Field staff in Small Business and Self-Employed (SB/SE) Division has been reduced from 768 Full-Time Equivalents (FTEs) in FY 2000 to 304 FTEs in FY 2002. Source: Innocent Spouse Tracking System (ISTS).

<sup>321</sup> Source: Innocent Spouse Tracking System (ISTS).



to inform taxpayers of specific and realistic timeframes when they can expect actions to take place.<sup>322</sup>

- ◆ Centralized processing at the Cincinnati Centralized Innocent Spouse Operation (CCISO) site, with additional staffing and specialized training, resulting in timelier, more consistent and accurate responses to taxpayers.
- ◆ Implementation of an automated decision-making tool leads examiners through the complex decision-making process. The tool was enhanced to include the initial screening to improve accuracy and timeliness.
- ◆ Revision of the IS claim form, instructions and publication to assist taxpayers in filing more accurate and complete claims.<sup>323</sup> The IRS developed these revisions in coordination with analysts from the Taxpayer Advocate Service's (TAS) Office of Individual Advocacy. A Spanish version of the claim form was also developed.<sup>324</sup>
- ◆ Development of a revised questionnaire to standardize assistance for taxpayers seeking innocent spouse. The revisions included feedback from practitioners and suggestions from TAS Systemic Advocacy, and will be available on the IRS website.<sup>325</sup> This should help taxpayers and practitioners file claims and reduce the need for burdensome subsequent contacts or information requests.

IRS is currently meeting IS program objectives in this area and continues to set goals for further improvement. Notable ongoing initiatives include:

- ◆ Modifying IS letters to provide accurate, understandable explanations about the disposition of IS claims and entitlement to appeal rights. The practitioner community and TAS are participating in this effort.
- ◆ Revising the Internal Revenue Manual (IRM), providing examiners with improved technical and procedural guidance.<sup>326</sup>
- ◆ Addressing issues related to domestic abuse. Examiners at the CCISO site are trained to deal with sensitive issues, including assistance with guidance relating to IRS regulations published in July 2002.<sup>327</sup> That regulation provides exception to the lack of actual knowledge requirement under the IRC §6015(c) election to separate liability where domestic abuse has existed in a marriage.

<sup>322</sup> Source: Innocent Spouse Tracking System (ISTS), July 2002.

<sup>323</sup> Form 8857, Request for Innocent Spouse Relief, (Rev. 5/02) and Publication 971, Innocent Spouse Relief, (Rev. 6/02).

<sup>324</sup> Form 8857SP, Request for Innocent Spouse Relief (in Spanish)(Rev. 6/02).

<sup>325</sup> Form 12510, Questionnaire for Requesting Spouse, published in June 2002, will be posted to the IRS Website in the near future.

<sup>326</sup> Internal Revenue Manual (IRM) 25.15.1.

<sup>327</sup> Internal Revenue Service Final Regulations, (T.D. 9003), Guidance on Innocent Spouse Relief Under Section 6015, July 17, 2002.

- ◆ Developing a customer satisfaction survey with assistance of the Gallup Organization and input from taxpayer and practitioner groups.
- ◆ Continuing outreach to seek feedback on innocent spouse issues from the practitioner community.

The following statistical indicators demonstrate how the implementation of these changes have positively impacted IS program results:

**TABLE 1.23.1**  
**PRE NOTIFICATION INVENTORY**

FY 2000 - 9/30/00		FY 2001 - 9/30/01		FY 2002 - 9/30/02	
Modules	Taxpayers	Modules	Taxpayers	Modules	Taxpayers
40,158	21,136	28,187	14,835	20,467	10,772

There has been a significant decrease in the number of taxpayers who have not been notified of claim disposition (Innocent Spouse pre-notification inventory). This inventory declined 27 percent in FY 2002, as of Sept. 30, 2002.<sup>328</sup> Overall, pre-notification inventories have dropped by 49 percent in the last two years, including a 30 percent decline in FY 2001.<sup>329</sup> Advising taxpayers of a decision regarding their claim as soon as possible is an important IRS goal for the program. The marked improvement in notifying taxpayers of the status of their IS claim occurred while the number of received claims remained fairly constant (a two percent decrease) during a similar timeframe in fiscal year 2001.<sup>330</sup>

The decrease in Innocent Spouse pre-notification inventories has also positively impacted TAS, as evidenced by the following table reflecting TAS receipts:<sup>331</sup>

<sup>328</sup> Source: Innocent Spouse Tracking System, Sept. 2002.

<sup>329</sup> Source: Innocent Spouse Tracking System.

<sup>330</sup> IRS received 50,616 claims in FY 2002 as compared to 51,609 in FY 2001. Source: Innocent Spouse Tracking System (ISTS).

<sup>331</sup> Source: Taxpayer Advocate Management Information System (TAMIS).



**TABLE 1.23.2**  
**TAXPAYER ADVOCATE SERVICE INNOCENT SPOUSE CASE RECEIPTS**  
**FISCAL YEAR - MONTH**

	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEPT	TOTAL
FY 2000	232	276	200	255	377	384	262	289	269	245	291	183	3263
FY 2001	227	179	140	236	314	331	247	209	182	159	187	141	2552
FY 2002	175	159	113	169	196	190	204	169	121	127	103	92	1818

In addition to the significant decrease in TAS Innocent Spouse case receipts, both the General Accounting Office (GAO)<sup>332</sup> and the Treasury Inspector General for Tax Administration (TIGTA)<sup>333</sup> have recently reported significant improvements in IS claim processing and management during 2002.

#### **A Continued Commitment to IS Program Improvements**

IRS operational priorities contain commitments for future improvement in the IS program. The IRS continues to identify weakness and address process improvements. For example, the standard for keeping taxpayers apprised of their case status is contact at least every 90 days. IRS's Centralized Innocent Spouse Case Review (CISCR) examines a statistically valid sample of closed innocent spouse cases. The success rate for meeting the 90-day contact goal is approximately 50 percent. Technological improvements are expected to be in place for FY 2004 to enable management to track and systematically address whether follow-up has occurred in 90 days.

The IRS found that many cases selected for CISCR resulted from a workload backlog, which has been substantially reduced. Because of customer service concerns, and to determine if employees are doing a better job on the more current cases than the aforementioned goal reflects, the IRS is sampling its 90-day status inventory.

<sup>332</sup> GAO Report, 02-558, *TAX ADMINISTRATION, IRS's Innocent Spouse Program Performance Improved; Balanced Performance Measures Needed*, April 24, 2002.

<sup>333</sup> TIGTA Report, 2002-40-067, *Numerous Efforts Are Taken to Educate Taxpayers on Innocent Spouse Eligibility Requirements*, March 2002.

As of July 1, 2002, the Small Business/Self-Employed Division began sending all non-protested post assessment partial and full grant claims to CCISO for end processing, including IDRS Master file 31 (MFT 31) adjustments.<sup>334</sup> In anticipation of improved accuracy and shorter processing timeframes, the MFT 31 process for CCISO has been moved to the Andover Wage & Investment Campus. Cross-trained screeners at CCISO are helping to close these accounts as Andover employees become more proficient in the process.

The recent TIGTA review did point out that untimely routing to CCISO of Form 8857, Request for Innocent Spouse Relief, still needs attention. The Innocent Spouse Project Office had addressed this concern in October 2000. However, in light of the review, a memorandum was issued in September 2002 with simplified procedures that require any IRS employee receiving an Innocent Spouse claim to promptly date stamp it and immediately forward the claim to CCISO.<sup>335</sup>

The National Taxpayer Advocate commends the IRS for its efforts to address the many administrative challenges presented by the statutory changes in the law regarding relief from joint and several liability. Oversight and responsibility for the innocent spouse program have in the past few months shifted to the Compliance unit of the Wage and Investment Division. The National Taxpayer Advocate will continue to monitor the management of the program under this restructuring to ensure that innocent spouse claims processing continues to improve.

<sup>334</sup> This is the process of separating the tax liability from a joint account to two separate accounts (one for each spouse) on claim cases in which relief has been granted.

<sup>335</sup> Source: Innocent Spouse Project Office (ISPO) Memorandum, 9/26/2002.

