

MSP
8**PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others****RESPONSIBLE OFFICIALS**

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DEFINITION OF PROBLEM

Over 20 years ago, Congress recommended the IRS “develop better information concerning the administration and effects of penalties” to ensure they promote voluntary tax compliance.¹ It is the IRS’s official policy to do so,² and many of the IRS’s stakeholders, including the National Taxpayer Advocate, have recommended that the IRS do more in this area.

The IRS has assigned responsibility for IRS-wide penalty policy to the Office of Servicewide Penalties (OSP). As the number of civil penalties has increased—from 14 in 1955 to more than 170 today—this responsibility has become more difficult.³ However, OSP has not been given the resources to conduct (or review) penalty research on a regular basis and has ignored TAS’s penalty research. OSP, an office buried at least three levels below the Small Business/Self-Employed (SB/SE) division Commissioner, cites insufficient resources, insufficient staffing, employees with the wrong skillsets, and a lack of access to penalty-related data as barriers to conducting such research.⁴ It also appears to lack the authority to implement any significant IRS-wide changes to penalty administration. Other IRS business units do not ask OSP for substantive comments before they implement major penalty initiatives or policy changes. Moreover, the IRS has not developed a plan to address the challenges faced by OSP, as it committed to do in 2009.⁵ As a result, some of the IRS’s penalty procedures are more likely to discourage than encourage voluntary compliance.⁶

1 See, e.g., H.R. REP. NO. 101-386, at 661 (1989) (Conf. Rep).

2 Policy Statement 20-1 (Formerly P-1-18), reprinted at IRM 1.2.20.1.1(1)-(2) (June 29, 2004).

3 IRM 20.1.1.1.1 (Nov. 25, 2011) (14 civil penalties in 1955); IRS response to TAS information request (July 10, 2014) (stating OSP is charged with “administering more than 170 different civil penalties”). The IRS only assessed 151 different penalties in fiscal year (FY) 2013). TAS research data from the Enforcement Revenue Information System (ERIS) on the Compliance Data Warehouse (CDW) (Oct. 8, 2014) (reflecting assessments of 151 different penalties—67 for individuals and 84 for businesses—for FY 2013).

4 IRS response to TAS information request (July 10, 2014); IRS Human Resources Reporting Center (HRRRC), Servicewide Penalties Organizational Chart (Sept. 20, 2014).

5 Government Accountability Office (GAO), GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009) (IRS response).

6 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). For a discussion of various problems with penalty procedures see, e.g., National Taxpayer Advocate 2007 Annual Report to Congress 275 (Most Serious Problem: *The Accuracy-Related Penalty in the Automated Underreporter Units*); National Taxpayer Advocate 2013 Annual Report to Congress 103 (Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*); National Taxpayer Advocate 2013 Annual Report to Congress 228 (Most Serious Problem: *The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Made Honest Mistakes*).

ANALYSIS OF PROBLEM

The IRS is Supposed to Ensure that its Penalty Policy Promotes Voluntary Compliance.

The last comprehensive reform of the Internal Revenue Code's (IRC's) penalty provisions was enacted in 1989, after careful study by Congress, the IRS, and other stakeholders.⁷ As part of these reforms, Congress recommended that the IRS “develop better information concerning the administration and effects of penalties” to ensure penalty provisions and the IRS's administration of them promote voluntary compliance.⁸ In a hearing leading up to the 1989 legislation, Senator Pryor explained that:

[t]he IRS places a low priority on collecting data necessary in the administration of those [sic] penalties. To use an analogy, I would find it very difficult to believe that a major U.S. company would manage a comparable program so vital to its business mission without essential data collection to analyze the success and failure of the program.⁹

The IRS adopted a policy statement consistent with Congress's recommendation. It states that:

- “The Office of Penalty and Interest Administration [a predecessor of OSP] must review and approve changes to the Penalty Handbook for consistency with Service Policy before making recommended changes.”
- “The Service collects statistical and demographic information to evaluate penalties and penalty administration, and to determine the effectiveness of penalties in promoting voluntary compliance.”
- “The Service continually evaluates the impact of the penalty program on compliance and recommends changes when the Internal Revenue Code or penalty administration does not effectively promote voluntary compliance.”¹⁰

More recently, the National Taxpayer Advocate, the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), the American Bar Association (ABA) Tax Section, and the American Institute of Certified Public Accountants (AICPA) have all recommended that the IRS collect more data on penalties and do more to analyze their effect on voluntary compliance.¹¹ Penalty analysis is increasingly difficult because the number of civil penalties the IRS administers has increased from 14 in 1955 to more than 170 today.¹² The IRS assessed about 37.9 million (or \$25.9 billion in aggregate) civil penalties in FY 2013, up from about 15 million (or \$1.3 billion in aggregate) in FY 1978 (the earliest year available).¹³ It also abated about 4.9 million civil penalties (or \$11.5 billion in aggregate) in FY 2013, up from 1.4 million (or \$338 million in aggregate) in FY 1978.¹⁴

7 See, e.g., Executive Task Force for Internal Revenue Commissioner's Penalty Study, *A Philosophy of Civil Tax Penalties* (Discussion Draft), reprinted in 111 DTR L-1 1988, 9-10 (June 9, 1988); H.R. REP. NO. 101-386 at 661 (1989) (Conf. Rep.).

8 H.R. REP. NO. 101-386 at 661 (1989) (Conf. Rep.) (also stating that, in connection with civil tax penalty reform, “the IRS should develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance”).

9 *Hearing Before the Comm. on Finance, Subcomm. on Private Retirement Plans and Oversight of the Internal Revenue Service*, 100th Cong. 2d Sess. 2 (Sept. 28, 1988) (Opening Statement of Sen. David Pryor).

10 Policy Statement 20-1 (Formerly P-1-18), reprinted at IRM 1.2.20.1.1(11)-(12) (June 29, 2004).

11 See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*); GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009); TIGTA, Ref. No. 2001-40-069, *Ineffective Administration of the Individual Taxpayer Penalty Program Creates Inequity* 9 (Apr. 2001); ABA Section of Taxation, *Statement of Policy Favoring Reform of Federal Civil Tax Penalties* 13 (Apr. 21, 2009); Am. Inst. of Certified Pub. Accountants, *Report on Civil Tax Penalties: The Need for Reform* 16 (Aug. 28, 2009).

12 IRM 20.1.1.1.1 (Nov. 25, 2011); IRS response to TAS information request (July 10, 2014).

13 IRS Data Book (FY 2013) (Table 17); IRS Data Book (FY 1978) (Table 13).

14 *Id.*

The IRS Does Not Regularly Study the Effect of Penalties on Voluntary Compliance.

The IRS has assigned responsibility for “reviewing and analyzing penalty information, researching penalty effectiveness on compliance trends, and determining appropriate action necessary to promote voluntary compliance” to OSP.¹⁵ Over 20 years after Congress’s recommendation and at least five years after the IRS’s stakeholders (identified above) recommended the IRS do more to study the effect of penalties on voluntary compliance—or at least develop a plan to do so—the OSP has neither produced nor reviewed much research regarding the extent to which penalties promote voluntary compliance (or noncompliance).

Since 2004, the OSP has reviewed only one inconclusive study concerning the effect of three penalties on voluntary compliance.¹⁶ The study did not prompt any policy changes. According to the IRS, it does not do more penalty research because:

[OSP does not have] sufficient resources with the specialized knowledge and skill sets nor access to all the various databases which could assist in civil penalty research and analysis ... the IRS functions OSP relies on to compile such data do not have specialized knowledge to apply all of the intricacies and nuances associated with civil penalty assessments and abatements ... [and] The separation of different specialized knowledge between two different IRS offices often results in misinterpretations of the type and extent of analyses needed for civil penalties. In addition, the massive amount of data needed to analyze behavior over multiple years as well as the numerous variables to be analyzed each year in order to fully determine a penalty’s impact on voluntary compliance is a barrier to effective data analysis.¹⁷

Despite this acknowledged lack of expertise and resources, since 2008 OSP has not obtained any new authority, resources, staffing, data/information, systems, or training, and its staff has diminished to six analysts.¹⁸ Further, OSP is buried in the IRS bureaucracy, reporting to the SB/SE Director of Examination Policy, a position three levels below the SB/SE Commissioner.¹⁹ The net effect of this situation is that the IRS has abdicated its responsibility to conduct effective penalty administration, as it continues to apply penalties without regard to whether its penalty-related policies further voluntary compliance.

15 IRM 20.1.1.1.3 (Dec. 11, 2009). See also IRM 20.1.6.1.1 (Sept. 17, 2010) (“Overall responsibility for the penalty programs is assigned to OSP ... OSP is charged with coordinating policy and procedures concerning the administration of penalty programs and ensuring consistency with the penalty policy statement”); IRM 4.24.9.1 (Oct. 26, 2012) (same).

16 In response to a TAS request to “provide any research OSP has conducted, requested, or reviewed and considered in evaluating penalty policy changes since ... 2004,” the IRS identified inconclusive research completed in 2011 by SB/SE research concerning the effect of the first time abatement (FTA) program on future compliance by business taxpayers. IRS response to TAS information request (July 10, 2014). It also identified a request for SB/SE Research to participate as facilitator for the Civil Penalties Administration Improvement Team (CPAIT), to assist “OSP with the Force Field Analysis results obtained during the Civil Penalties Forums in 2011,” and to study the subsequent compliance of the taxpayers that received FTF, FTP, or FTD penalties. *Id.* However, this last study “did not meet the stated objectives because Exam Policy sought a dedicated database” and is currently being conducted by the IRS Research Analysis and Statistics (RAS) function. *Id.* The IRS’s response also suggests that OSP does not contract with external researchers or review penalty research conducted by them.

17 IRS response to TAS information request (July 10, 2014).

18 *Id.* IRS HRRC, *Service-wide Penalties on Rolls List* (Sept. 20, 2014).

19 IRS HRRC, *Service-wide Penalties, Organization Chart* (Sept. 20, 2014).

OSP Does Not Regularly Make or Recommend Changes to Enhance Voluntary Compliance, as Contemplated by the Policy Statement.

In response to a TAS request, OSP did not identify any significant changes to IRS-wide penalty policy that it had implemented to enhance voluntary compliance in the last ten years.²⁰ In 2009, OSP recommended that the penalty under IRC § 6657 for bad checks be extended to various types of electronic payments.²¹ However, it has not offered any other legislative recommendations.

Since 2004, the Office of Servicewide Penalties has reviewed only one inconclusive study concerning the effect of three penalties on voluntary compliance.

The IRS Has Not Implemented TAS's Research-Based Penalty Policy Recommendations to Improve Voluntary Compliance.

TAS recently completed a number of penalty-related studies and analyses about the appropriate use of penalties. A 2008 TAS study identified areas where penalty administration deviated from core principles articulated in 1989, potentially discouraging voluntary compliance.²² Between 2011 and 2013, TAS repeatedly analyzed the effect of the IRS's disproportionate "offshore penalty" on voluntary compliance and suggested reforms that could help it better promote voluntary compliance.²³ A 2013 TAS study analyzed the effect of accuracy-related penalties on voluntary compliance.²⁴ Although these studies identified administrative changes that could improve voluntary compliance, with the exception of some recent recommendations relating to the "offshore penalty," the IRS has not adopted them.²⁵

The IRS Still Imposes Penalties Automatically—Before Determining if They Actually Apply.

A 2008 TAS study discussed the IRS's policy of automatically proposing the negligence penalty when the IRS finds a mismatch between the taxpayer's return and an information return in two or more years, and the taxpayer does not respond to the IRS's form letter by satisfactorily explaining the apparent discrepancy.²⁶ In such cases the IRS is not required to make an outgoing call (unless the taxpayer responds to the letter) to determine if the taxpayer was actually negligent or had reasonable cause.²⁷ The study observed

20 IRS response to TAS information request (July 10, 2014) (describing, instead, challenges from implementing newly enacted legislation, updating and maintaining IRMs, various forms, publications, letters, and notices, and from responding to executive requests, congressional inquiries, TIGTA investigations, and GAO reports).

21 *Id.*

22 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*); National Taxpayer Advocate 2008 Annual Report to Congress 414 (Legislative Recommendation: *Reforming the Penalty Regime*).

23 See, e.g., National Taxpayer Advocate 2015 Objectives Report to Congress; National Taxpayer Advocate 2013 Annual Report to Congress 223; National Taxpayer Advocate 2012 Annual Report to Congress 134-53; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29 [collectively the *OVD Reports*].

24 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). The 2013 study built on a 2012 TAS study which suggests trust for the IRS may promote voluntary compliance more strongly than deterrence—the possibility that the IRS will detect and penalize tax cheating—findings with significant implications for penalty administration. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 13 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

25 For a discussion of the OVD programs, see, e.g., the *OVD Reports*.

26 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*). See also National Taxpayer Advocate 2007 Annual Report to Congress 275 (Most Serious Problem: *The Accuracy-Related Penalty in the Automated Underreporter Units*).

27 Exam generally sends Letter 566 to ask for documentation before sending Letter 525 to propose a deficiency and penalty. IRM 4.19.10.4.10.1, *Initial Contact Letter (ICL) Procedures* (Jan. 1, 2013). However, even Exam will only try to call the taxpayer if it receives a response. See IRM 4.19.13.11, *No Response and Unagreed Cases* (Jan. 1, 2013).

that many stakeholders object to such automated penalty procedures,²⁸ which seem to violate direction from Congress to “make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later.”²⁹ The policy also ignored concerns expressed in a House Budget Committee report:

[t]hat the present-law accuracy-related penalties (particularly the penalty for substantial understatements of tax liability) have been determined too routinely and automatically by the IRS. The committee expects that enactment of standardized [reasonable cause] exception criterion will lead the IRS to consider fully whether imposition of these penalties is appropriate **before** determining these penalties (emphasis added).³⁰

TAS recommended the IRS discontinue its practice of assessing accuracy-related penalties for negligence before actually determining whether the taxpayer was negligent.³¹ Rather than *reconsidering* its automated approach to penalties, the IRS *extended* it to the penalty for improperly claiming credits.³²

A 2013 TAS study suggested that accuracy-related penalties do not improve reporting compliance among taxpayers subject to default assessments, such as those resulting from automated programs, and five years later these taxpayers appeared *less* compliant than those not subject to penalties.³³ The IRS has neither disputed the findings of this study—that such automated penalty assessments policies undermine long-term voluntary compliance—nor agreed to change its policies.

The IRS’s Offshore Voluntary Disclosure (OVD) Programs Extracted Disproportionate Penalties From Unrepresented Taxpayers Trying to Correct Inadvertent Errors.

Another core principle identified in 1989 as consistent with voluntary compliance—as well as the research discussed above—is that penalties should be perceived as proportionate. However, the IRS’s policies create the perception that it is using its broad discretion in applying penalties for failure to file information returns—such as the penalties for failure to file Forms 3520, 3520-A, 5471, 5472, 926, 8865, 8938, or a Foreign Bank Account Report (FBAR)—to extract seemingly arbitrary and disproportionate “offshore penalties” in connection with its Offshore Voluntary Disclosure (OVD) settlement programs.³⁴ Moreover, these programs penalized unrepresented taxpayers with small unreported accounts—those most likely to

28 Am. Inst. of Certified Pub. Accountants, *Report on Civil Tax Penalties: The Need for Reform* (Aug. 28, 2009); ABA Tax Section, *Comments Concerning Possible Changes to Penalty Provisions of the Internal Revenue Code* (1999).

29 H.R. Rep. No. 101-386, at 661 (1989) (Conf. Rep.). See also IRC § 6751(b)(1) (generally requiring penalties to be personally approved by a supervisor before assessment unless automatically calculated through electronic means).

30 H.R. Rep. No. 101-247 at 2863 (1989) (Budget Comm. Rep.).

31 See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*).

32 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 182 (Most Serious Problem: *The IRS Assessed Penalties Improperly, Refused to Abate them, and Still Assesses Penalties Automatically*) (discussing IRS’s use of the accuracy-related penalties for credit claims); National Taxpayer Advocate 2013 Annual Report to Congress 108 (Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*) (discussing the “penalty” for improperly claiming the Earned Income Tax Credit (EITC) (*i.e.*, the two-year ban)); National Taxpayer Advocate 2013 Annual Report to Congress 311 (Legislative Recommendation: *Allocate to the IRS the Burden of Proving It Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit*). The IRS views the EITC two-year ban as a procedural rule, rather than a penalty. IRS response to TAS information request (July 10, 2014). Regardless of its characterization, the rule penalizes taxpayers, and, if it creates the impression the IRS is unfair, it likely affects voluntary compliance.

33 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

34 See, e.g., *OVD Reports*.

have made inadvertent or unintentional mistakes that they were trying to correct—more severely than criminal tax evaders with large accounts.³⁵

To make matters worse, the IRS’s computation of the offshore penalty, which is often counterintuitive, is not subject to appeal or adequate explanation. The IRS does not publish its interpretations of the frequently asked questions (FAQs) describing how the offshore penalty is computed and taxpayers are not entitled to speak to the IRS employee (*e.g.*, a technical advisor or attorney) who decided how to compute it. This lack of transparency and due process in connection with the offshore penalty computation is perceived as unfair and violates the spirit, if not the letter, of the IRS’s penalty policy statement, which states:

[T]he Service will demonstrate the fairness of the tax system to all taxpayers by: Providing every taxpayer against whom the Service proposes to assess penalties with a reasonable opportunity to provide evidence that the penalty should not apply; Giving full and fair consideration to evidence in favor of not imposing the penalty, even after the Service’s initial consideration supports imposition of a penalty ...³⁶

Moreover, the perceived unfairness, and lack of transparency and due process in the OVD programs violates the IRS’s recently-adopted Taxpayer Bill of Rights. Those rights include *the right to be informed, the right to challenge the IRS’s position and be heard, the right to appeal an IRS decision in an independent forum, and the right to a fair and just tax system.*³⁷

The IRS Has Resisted Research-Driven Recommendations to Improve the Effect of Penalties on Voluntary Compliance.

As noted above, OSP has not reviewed TAS’s studies or other studies conducted by outside researchers or academics. Moreover, OSP appears to disagree with direction from Congress to “make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later,”³⁸ because it “does not consider it unfair to taxpayers for the IRS to assert penalties through a systemic process which applies distinct criteria to identify **potential** instances of noncompliance ...” (emphasis added).³⁹

Further, OSP responded to TAS’s suggestion that the IRS stop automating various penalty assessments by stating that it had no authority to change those procedures even though they were described in the Penalty Handbook, which it is responsible for updating.⁴⁰ According to OSP, any change in penalty policy requires a collaborative decision between OSP, IRS Counsel, and the business operating divisions impacted by such change.⁴¹ However, other IRS business units do not ask OSP for substantive comments before they implement major penalty policy changes or initiatives. For example, other business units did not ask OSP for substantive comments before implementing the 2009, 2011, 2012 or 2014 OVD programs or before automating the assertion of penalties for failure to file Form 5471 in 2009 or Form 5472

35 See *id.* These policies are also inconsistent with Congress’ direction in 1989. See H.R. REP. No. 101–247 at 1405 (Budget Committee) (“The IRS should better use its limited enforcement resources to ensure that taxpayers who continually fail to comply with the reporting requirements are identified and penalized, rather than focusing only on taxpayers who are working with the IRS in an attempt to comply with the law.”).

36 IRS Policy Statement 20-1 (Formerly P-1-18), *reprinted* as IRM 1.2.20.1.1 (June 29, 2004).

37 IRS, Pub. 1, *Your Rights as a Taxpayer* (Rev. 6-2014).

38 H.R. REP. No. 101-386, at 661 (1989) (Conf. Rep.). See also H.R. REP. No. 101-247 at 2863 (1989) (Budget Comm. Rep.).

39 IRS response to TAS information request (July 10, 2014).

40 *Id.* Meeting with OSP executives (Mar. 21, 2014).

41 *Id.*

in 2013.⁴² The result of this lack of communication and splintered responsibility is an ineffective penalty regime that harms taxpayers and does not foster voluntary compliance.

The IRS Still Has No Plan to Evaluate Penalty Administration or the Effect of Penalties on Voluntary Compliance.

In response to a 2009 GAO report, the IRS agreed that OSP would develop a plan to evaluate penalty administration and the impact of penalties on voluntary compliance.⁴³ Recognizing that this plan should incorporate comments from internal and external stakeholders, the IRS conducted two civil tax penalty forums in June 2011 and formed a Civil Penalties Administration Improvement Team (CPAIT).⁴⁴ However, the IRS put development of the plan on hold due to budgetary constraints.⁴⁵ The draft plan has not been finalized, approved, or provided to GAO or TAS.⁴⁶

CONCLUSION

The IRS and its stakeholders, including Congress, all agree that the IRS should use data and research to ensure that penalties promote voluntary compliance, and change IRS procedures or make recommendations for legislative change when they do not. However, the IRS has delegated this responsibility to OSP and declined to provide it with the resources necessary to do so. OSP's staff of six employees does not conduct penalty research. They assert they do not have the skills or access to data they would need to conduct such research. They also face barriers in obtaining assistance from IRS research functions. Moreover, OSP does not review private-sector research or act on TAS's penalty research. OSP apparently has not been given authority to do so. In addition, the IRS still does not have a plan to evaluate penalty administration and the impact of penalties on voluntary compliance.

It will be difficult for the IRS (or OSP) to evaluate the effect of penalties if it ignores prior research. It would be easier for the IRS to evaluate their effects in light of the research and conclusions already reached by the IRS and its stakeholders. For example, the findings of various studies by TAS and others are consistent with what the IRS and Congress found in 1989 – penalties promote voluntary compliance when they are perceived as fair and administered in a way that is consistent with fundamental

In response to a TAS request, OSP did not identify any significant changes to IRS-wide penalty policy that it had implemented to enhance voluntary compliance in the last ten years.

42 IRS response to TAS information request (July 10, 2014) (indicating that the business units merely asked OSP for new penalty reference numbers).

43 GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009).

44 IRS response to TAS information request (July 10, 2014).

45 *Id.*

46 *Id.*

taxpayer rights.⁴⁷ Otherwise, they are more likely to erode voluntary compliance, wasting IRS resources and decreasing government revenues. This conclusion is also consistent with the IRS's recently-adopted Taxpayer Bill of Rights.⁴⁸ If OSP were more effective in protecting those core principles and conducting research or reviewing research by TAS and other stakeholders, it could better ensure that penalty rules and administration actually promote voluntary compliance.

RECOMMENDATION

The National Taxpayer Advocate recommends that the IRS:

1. Finalize a plan for OSP (or a successor organization) to ensure that all parts of the IRS are administering penalties to promote voluntary compliance in accordance with congressional directives and the IRS policy statement.
2. Provide OSP with sufficient authority, resources, staffing, training, and access to data and systems to ensure the IRS is achieving its penalty-related objectives.
3. Require that all penalty policies and initiatives owned by other IRS business units be incorporated into the IRM and substantively reviewed by OSP for consistency with IRS-wide penalty policy before they are implemented. OSP should also review all previously-adopted policies.
4. Direct OSP to partner with private-sector researchers to study the effect of penalties on voluntary compliance.
5. Direct OSP to compile, review, and consider current and historical internal and external penalty studies (including TAS studies) in connection with any reevaluation of (or change to) IRS penalty policy or administration.
6. Direct OSP to publish the studies it considers and the conclusions it reaches after any such review, so that internal and external IRS stakeholders can build on and contribute to its analysis.

⁴⁷ A number of studies other than those described above lend support to this conclusion. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 13 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, § 6 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*) (describing wide range scholarly studies); Swedish Tax Agency, *Right From The Start, Research and Strategies* 38-51 (Aug. 2005) (surveying papers from various disciplines, and concluding that trust for tax agencies is an important determinant of voluntary compliance); Kristina Murphy, *The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders*, 28 LAW & HUM. BEHAV 187 (Apr. 2004) (finding that perceptions of procedural fairness and trust in the taxing authority had an impact on the motivation to comply); Tom R. Tyler, *Why People Obey the Law* 58-62 (Princeton Univ. Press 2006) (finding that respect and support for enforcement agencies has a significant positive impact on compliance after controlling for other variables); *Taxpayer Compliance, Volume 1: An Agenda for Research* 118 (Jeffrey A. Rother, John T. Scholtz, and Ann Dryden Witte eds., Univ. of Penn. Press 1989) (summarizing various studies that suggest attitudes toward the IRS, law, and government may have an impact on tax compliance). See also Joint Committee on Taxation, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (Nov. 24, 1998) (describing the 1998 IRS reorganization as needed to restore public confidence in the IRS, in large part, because “the Congress believed that most Americans are willing to pay their fair share of taxes, and that public confidence in the IRS is key to maintaining that willingness.”). Of course, penalties may also deter noncompliance and demonstrate the fairness of the tax system to those who are compliant. Policy Statement 20-1 (Formerly P-1-18), *reprinted as IRM 1.2.20.1.1(1)-(2)* (June 29, 2004).

⁴⁸ The notion that only penalties that are perceived as being fair and administered fairly have a positive effect on voluntary compliance is so well established that GAO suggested: “In addition to analyses related to voluntary compliance that could be done internally, by developing a plan, OSP may be able to identify other means of developing information useful to gauging penalties’ effect on voluntary compliance. Taxpayer surveys or focus groups, for instance, could provide information on taxpayers’ perceptions about the fairness of penalties.” GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* 10 (June 2009).