

NATIONAL TAXPAYER ADVOCATE

# ANNUAL REPORT TO CONGRESS

Executive  
Summary

Preface and  
Highlights

2015





*This report is dedicated to  
my good friend*

*Chris Bergin,*

*for his tireless advocacy for  
transparency  
in the tax system  
and of  
taxpayer rights  
as fundamental to  
the fairness of that system.*



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## PREFACE: Introductory Remarks by the National Taxpayer Advocate

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### HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate's 2015 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

The year 2015 has been a memorable one for taxpayer rights. On November 19 through 21, over 160 people from 22 countries gathered at the National Archives and the Internal Revenue Service to participate in the Inaugural International Conference on Taxpayer Rights. The conference was convened by the National Taxpayer Advocate and co-sponsored by the American Bar Association Section of Taxation, the American College of Tax Counsel, the American Tax Policy Institute, the International Association of Tax Judges, the International Fiscal Association — USA Branch, and Tax Analysts. It included two days of presentations by speakers from countries as diverse as South Africa, Italy, Greece, Mexico, Sweden, Canada, England, Australia, and the United States, as well as a mini-conference on the third day with a panel of, and discussions by, taxpayer advocates and ombuds from around the world. The conference laid a foundation for continuing work and scholarship in the area of taxpayer rights, particularly as they derive from human rights' conventions, constitutional law, and statutes.<sup>1</sup>

On the evening of the first day of the International Conference on Taxpayer Rights, I stood in the Rotunda of the National Archives and viewed the documents on which the United States is founded — the Declaration of Independence, the Constitution, and the Bill of Rights. I was struck by James Madison's language quoted in a display about our nation's path to adopting a Bill of Rights:

I think we should obtain the confidence of our fellow citizens in proportion as we fortify the rights of the people against the encroachments of the government.

It is fitting that, less than one month after I read this statement at the historic conference, Congress passed and the President signed into law legislation that codified the provisions of the Taxpayer Bill of Rights (TBOR), an act I have been advocating for since 2007.<sup>2</sup> The need for and protections afforded by the TBOR cannot be overstated. In today's environment of low confidence and even distrust of the federal government and the IRS, the agency's adherence to the principles of the TBOR will demonstrate to taxpayers that they have reason to trust that it will administer the nation's tax laws fairly and justly.

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- 1 To see the conference agenda and abstracts of papers, visit [www.taxpayerrightsconference.com](http://www.taxpayerrightsconference.com). As papers from the conference are formally published in Tax Notes, The Tax Lawyer, and other journals, we will make them publicly available on this website. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 401 (2015). The law requires the Commissioner to "ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title." The bill provides that these rights include the *right to be informed*, the *right to quality service*, the *right to pay no more than the correct amount of tax*, the *right to challenge the position of the Internal Revenue Service and be heard*, the *right to appeal a decision of the Internal Revenue Service in an independent forum*, the *right to finality*, the *right to privacy*, the *right to confidentiality*, the *right to retain representation*, and the *right to a fair and just tax system*. To its credit, the IRS itself announced its adoption of the Taxpayer Bill of Rights in June 2014. However, congressional action carries the force of law and makes a significant statement about the value our elected representatives place on taxpayer rights.
  - 2 The National Taxpayer Advocate has been recommending that Congress codify the Taxpayer Bill of Rights since 2007. See National Taxpayer Advocate 2007 Annual Report to Congress 478-98 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payment*).

The Taxpayer Bill of Rights is the roadmap to effective tax administration. Congress has set the IRS on this path by codifying the TBOR. It is now up to the IRS to more fully incorporate taxpayer rights into everything it does. However, I have significant concerns that the IRS is embarking on a path that will unintentionally undermine taxpayer rights rather than enhance them, thereby eroding taxpayer trust further. I discuss these concerns in the remainder of this preface, and specifically in the first Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive “Future State” Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet.*

### The IRS Future State Vision and Its Implications for Taxpayer Rights

In response, in part, to significant budget cuts since 2010, the IRS has undertaken a multi-year exercise to develop a concept of operations (CONOPS) or “future state vision.” This exercise is long overdue and I commend the IRS for undertaking it. Not surprisingly, the IRS future state now under internal discussion proposes changes in agency operations that assume a constrained funding environment and therefore minimizes agency costs. As a result, these proposed changes have serious ramifications for taxpayers and taxpayer rights. Most significantly, the IRS future state vision redefines tax administration into a class system, where only taxpayers who are the most *noncompliant* or who can “pay to play” will receive concierge-level service or personal attention.<sup>3</sup> The compliant or trying-to-comply taxpayers will be left either struggling for themselves or paying for assistance they formerly received for free from the IRS.

The language in the few future state documents that are publicly available is commendable enough.<sup>4</sup> For example, there is laudatory language about improving taxpayer service by giving taxpayers self-service options (“Facilitate voluntary compliance by empowering taxpayers with secure innovative tools and support”) and by working with third parties such as software companies, Circular 230 tax professionals, and other preparers (“Leverage and collaborate with external stakeholders”). There is discussion about being data-driven (“Select highest value work using data analytics and a [sic] robust feedback loops”) and conducting behavioral research (“Understand non-compliant taxpayer behavior and develop approaches to deter and change it”). I note, however, that there is no stated commitment to understanding *compliant* taxpayer behavior and developing approaches to *maintain and enhance it*. The focus of this document is primarily on enforcement challenges.

Yet even as the IRS has been and is now holding internal discussions, it is eliminating services without any future state substitutes for those services in place. As we describe in the #1 Most Serious Problem and throughout this report, the IRS is reducing assistance to taxpayers despite the absence of significant research into taxpayers’ needs and preferences for assistance or the effect of service reductions on taxpayers’ willingness or ability to comply voluntarily with their tax obligations. The implications of these decisions and actions are far-reaching and should be discussed publicly *before* the IRS implements them.

### A Brief Level-Setting: The Current State of Tax Administration Today

For fiscal year (FY) 2015, the IRS collected over \$2.8 trillion dollars (net of refunds), or over 90 percent of federal receipts. Figure 1 below shows the breakdown of contributors to the public fisc by type of tax payment.

3 I am indebted to Professor Keith Fogg, Visiting Professor of Law and Director of Federal Tax Clinic Legal Services Center at Harvard Law School, for his inspired use of the phrase “concierge service.”

4 See, e.g., *Tax Enforcement in a Resource-Challenged World* (32nd Annual National Institute on Criminal Tax Fraud and the Fifth National Institute on Tax Controversy, Las Vegas, NV, Dec. 9-11, 2015) slide 7. All quotes in this paragraph are from this document.

**FIGURE 1, Federal Tax Receipts by Type of Tax, FY 2015<sup>5</sup>**

Tax Type	Trillions of Dollars	Percent of Revenue
Individual Income Taxes	\$1.541	47%
Corporate Income Taxes	\$0.344	11%
Social Security/Retirement Benefits	\$1.065	33%
Excise Taxes	\$0.098	3%
Other	\$0.201	6%

Almost half of federal tax receipts are from individuals, including sole proprietors. Another third are paid by employers — many of which are small businesses. Yet the tax administration issues impacting these taxpayers get very little attention these days — particularly the needs and preferences of individual taxpayers. Note that about 45 percent of individual taxpayers have income at or below 250 percent of the Federal Poverty Level and thus are considered by Congress as unable to afford professional representation in tax disputes.<sup>6</sup> Keep this in mind as I describe the reality of tax administration for the masses of individual and small business/self-employed taxpayers.

During FY 2015, the IRS received over 100 million phone calls from taxpayers or their representatives.<sup>7</sup> Here is a snapshot of what they experienced:

**FIGURE 2, IRS Telephone Performance on Accounts Management and Select Lines<sup>8</sup>**

Phone Line	Level of Service	Average Speed of Answer (minutes)
Accounts Management	38.1%	30.5
Taxpayer Protection Unit	24.6%	29.6
Installment Agreements/Balance Due	37.0%	34.8
NTA Toll-Free	43.7%	16.2
Practitioner Priority Service	47.6%	46.6

The “Level of Service” (or LOS) refers to the percentage of calls the IRS answers among all calls routed to customer service representatives. On all Accounts Management telephone lines combined, the IRS answered only about 38 percent of its calls — meaning about 62 percent of calls simply didn’t get through. The 38 percent of taxpayers who spoke with an assistor waited on hold an average of over 30 minutes before reaching a representative. But there was considerable variation among the IRS’s dozens of phone lines, as Figure 2 indicates.

5 Congressional Budget Office, *The Budget and Economic Outlook 2012-2025*, 95; IRS FY 2016 Budget in Brief.

6 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File (Tax Year 2014). Internal Revenue Code (IRC) § 7526 provides that taxpayers with incomes at or below 250 percent of the Federal Poverty Level who are in controversies with the IRS are eligible for *pro bono* or nominal fee assistance from Low Income Taxpayer Clinics.

7 IRS, Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total* (Sept. 30, 2015).

8 IRS, JOC, *Snapshot Reports: Product Line Detail* (Sept. 30, 2015).

As we have described in this year's Most Serious Problems about revenue protection and identity theft,<sup>9</sup> IRS fraud detection filters in FY 2015 had false positive rates ranging from 30 to 37 percent. In the Taxpayer Protection Program (TPP), IRS filters suspend return processing when they identify a risk of identity theft. To verify one's identity and continue return processing, a taxpayer can either call the IRS or try to authenticate online. The IRS detected and stopped approximately 4.8 million suspicious tax returns from January 1 through November 30, 2015. Well over 40 percent of these suspended returns are a result of the TPP, which had a false positive rate of 36.2 percent for this same timeframe. (This false positive rate is up from 19.8 percent for calendar year 2014).<sup>10</sup> All of these legitimate taxpayers were desperately attempting to free up their refunds, yet at one point during the filing season the level of service on the TPP line was below ten percent for three consecutive weeks — meaning more than 90 percent of the calls were not answered!<sup>11</sup> At another point the wait time was 60 minutes.<sup>12</sup> By the end of the fiscal year, the service levels were somewhat improved but still abysmal — 24.6 percent LOS and a 29.6 minute wait time.

Taxpayers who filed a balance due return and attempted to call the IRS during 2015 to make payment arrangements faced another daunting task. The IRS sends these taxpayers a series of notices that list a phone number to call; this is the same phone line a taxpayer selects to make payment arrangements if he or she calls the main toll-free "1040" number. Yet in FY 2015, the LOS on that line was 37.0 percent, and the average speed of answer (ASA) was 34.8 minutes. That is, *almost two-thirds* of these calls went unanswered. Now, these are taxpayers who owe the federal government money. They are calling to pay their taxes, or they are calling to tell the IRS they can't pay their taxes because they are experiencing economic hardship. Yet the IRS isn't able to pick up the phone to talk to them!

What happens to these taxpayers when the IRS doesn't pick up the phone? Well, after a certain period of time, the taxpayer's account is moved to the Automated Collection System (ACS), which, true to its name, searches out lien and levy sources so it can *automatically* file a Notice of Federal Tax Lien against the taxpayer's property or levy upon the taxpayer's bank account or wages. The IRS doesn't know the taxpayer has been trying to call it. Nor does the IRS make any effort to call the taxpayer before it automatically takes enforcement action against the taxpayer. By the time the taxpayer gets assigned to ACS, the IRS assumes the taxpayer has been unresponsive and is not trying to comply — despite the lousy levels of service on the pre-ACS phone lines.

How do these taxpayers feel when the first contact they actually have with the IRS is a lien filing or a levy on their wages? How will they behave with respect to their tax obligations in the future? What message is the IRS sending when it doesn't engage with the taxpayer and then takes an enforcement action? These are not theoretical questions. They go to the heart of the relationship the taxpayer has with his or her government (as represented by the IRS), and they have everything to do with the degree to which a taxpayer is willing to comply with the tax laws.

9 See Most Serious Problem: *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program*, *infra*; Most Serious Problem: *Identity Theft (IDT): The IRS's Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long*, *infra*.

10 IRS, *Global Identity Theft Report* (Nov. 2015).

11 IRS, JOC, *FY 2015 Weekly TPP Snapshot* (weeks ending Feb. 28, 2015 [9.7 percent], Mar. 7, 2015 [7.6 percent], and Mar. 14, 2015 [9.8 percent]).

12 IRS, JOC, *FY 2015 Weekly TPP Snapshot* (week ending Feb.28, 2015).

Before I discuss taxpayer or tax morale,<sup>13</sup> consider these data points. Ninety-eight percent of all tax revenue collected by the IRS is paid voluntarily. Less than two percent is collected through direct enforcement action.<sup>14</sup> If the IRS were to collect ten percent less in enforcement revenue, tax revenue would drop by less than \$6 billion. But if voluntary payments were to decrease by ten percent, tax revenue would drop by more than \$280 billion.<sup>15</sup> In light of this data, just where should we be putting our attention and our resources?

### A Discussion of First Principles: What Is Taxation About?

Simply put, taxation involves taking money from one person and applying that taking to the greater good of many, if not all. That is an extraordinary thing to ask of people. A tax system depends on taxpayers being willing to offer up their hard-earned or saved dollars and let their money be applied to everyone's — or someone else's — benefit.

So the central question in tax administration is: How do we promote that willingness? What does the tax administrator need to do to maintain and expand taxpayers' willingness to pay their taxes? Stated another way, how should the tax administrator behave so it doesn't undermine or lose taxpayers' willingness to comply with the tax laws? The answers to these questions should drive both the current and future state of the IRS.

### The Dynamics Between Power and Trust, Taxpayer and the Tax Agency

When we talk about taxpayers' willingness to comply, we really have to consider the relationship between the taxpayer and the government. This essentially involves an analysis of the dynamics between power and trust. Specifically, the government — and by extension, the tax agency — holds the awesome power of the state. For the tax system to work, the taxpayer has to trust that the government will use its power wisely and legitimately. If it does, taxpayers will be more willing to comply with the tax laws and meet their tax obligations.<sup>16</sup>

Power can be either coercive or legitimate.<sup>17</sup> Trust can be reason-based or learned. The dynamics between the type of power and the type of trust define and influence the climate of government-taxpayer interaction. We can have an antagonistic environment, or one that is service-oriented, or one that is cooperative. These climates of interaction define the kind of compliance we can achieve. In an antagonistic

13 "Tax Morale" is the "collective name for all the non-rational factors and motivations — such as social norms, personal values and various cognitive processes — that strongly affect an individual's voluntary compliance with laws." National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 139 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

14 In FY 2015, the IRS collected total tax revenue of about \$3.3 trillion and refunded about \$400 billion. Only \$54.2 billion (about 1.9 percent) is classified as "Enforcement Revenue." Government Accountability Office (GAO), GAO-16-146, *Financial Audit: IRS's Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015), available at [www.gao.gov/assets/680/673614.pdf](http://www.gao.gov/assets/680/673614.pdf).

15 About \$3.3 trillion in gross revenue collections less refunds of \$403 billion and less enforcement revenue of \$54.2 billion comes to about \$2.84 trillion in net taxes voluntarily paid. Ten percent of \$2.84 trillion is more than \$280 billion. By contrast, ten percent of IRS enforcement revenue is only slightly greater than \$5.4 billion. See GAO, GAO-16-146, *Financial Audit: IRS's Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015).

16 See Tom R. Tyler, *Why People Obey the Law* (Princeton, Princeton University Press) 2006. For a more recent exploration of the role of procedural justice in shaping perceptions of legitimacy of law enforcement agencies and actions, see Tom R. Tyler, Phillip Atiba Goff & Robert J. MacCoun, *The Impact of Psychological Science on Policing in the United States: Procedural Justice, Legitimacy, and Effective Law Enforcement*, *Psychological Science in the Public Interest*, Vol. 16(3), 75-109 (2015).

17 For a detailed analysis of the dynamic between power, trust, and the compliance environment, see Katharina Gangl, Eva Hofmann & Erich Kirchler, *Tax Authorities' Interaction with Taxpayers: A Conception of Compliance in Social Dilemmas by Power and Trust*, *NEW IDEAS IN PSYCHOLOGY* 37, 13-23 (2015). See also Erich Kirchler, *The Economic Psychology of Tax Behaviour* (Cambridge, Cambridge University Press) (2007).

environment, you will have enforced compliance — which is very expensive, and often involves the use of both coercive and legitimate power, but very little trust. In a service-oriented environment, you will have voluntary compliance — but it is still a choice by the taxpayer; the taxpayer is learning that the government can be trusted to apply its power legitimately. The holy grail for tax administration is a cooperative environment of committed compliance — where compliance has become a way of life. The taxpayer trusts and expects the government will use its power appropriately and wisely (legitimately) and thus is willing to come forward when he or she makes mistakes, knowing that the government will listen and engage with the taxpayer.<sup>18</sup> The taxpayer, in turn, is willing to make the personal sacrifice of paying taxes for the greater good.

### The IRS Is Increasingly a Pay-to-Play System, Which Erodes Trust in the Tax System

Reading between the lines of the IRS future state vision, the IRS appears to replace traditional IRS employee-to-taxpayer interaction with online and third-party interactions. That is, the vision essentially eliminates IRS-taxpayer personal interaction except in the context of enforcement actions. Now, I understand that virtually all taxpayers would love to live their lives without *any* interaction with the IRS. But as I noted earlier, tens of millions of taxpayers need to contact and interact with the IRS every year. Over nine million taxpayers receive post-refund notices and experience refund delays every year.<sup>19</sup> The issues underlying those interactions are vitally important to each of those taxpayers — and the resolution of those contacts could literally impact the livelihood or survival of a person or a business.<sup>20</sup>

In the IRS future state, if a taxpayer wants to talk with the IRS about his concerns, he will be pretty much out of luck. He will be directed first to a website or an online account, the outlines of which are very vague and the creation of which may undermine significant taxpayer protections.<sup>21</sup> The online

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18 This is why the Taxpayer Bill of Rights, adopted by the IRS in 2014 and codified on December 18, 2015, by the Consolidated Appropriations Act, 2016, includes the *right to challenge the IRS's position and be heard*. It is not enough for the taxpayer to have the right to challenge the IRS; the IRS must also *listen* to the taxpayer and *hear* his complaint.

19 For a breakdown of these notices, see Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts with Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*, *infra*.

20 In the Most Serious Problems section of this Annual Report, we have provided numerous examples of the harm that can befall taxpayers if they are unable to make personal contact with the IRS. See, *e.g.*, Most Serious Problems: *Practitioner Services: Reductions in the Practitioner Priority Service Phone Line Staffing and Other Services Burden Practitioners and the IRS*, *infra*; *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program*, *infra*; *Identity Theft (IDT): The IRS's Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long*, *infra*; *Automated Substitute for Return (ASFR) Program: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*, *infra*; *International Taxpayer Service: The IRS's Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*, *infra*; *Individual Taxpayer Identification Numbers (ITINs): IRS Processes Create Barriers to Filing and Paying for Taxpayers Who Cannot Obtain Social Security Numbers*, *infra*; *Earned Income Tax Credit (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-Filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility*, *infra*; *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*, *infra*.

21 For a detailed discussion about individual and tax professional access to online accounts, see Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*, *infra*; and Most Serious Problem: *Preparer Access to Online Accounts: Granting Uncredentialed Preparers Access to an Online Taxpayer Account System Could Create Security Risks and Harm Taxpayers*, *infra*. For a discussion of our concerns about "self-service" and "just-in-time" options, see National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical As the IRS Develops a Real-Time Tax System*).

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**When you add on the additional burden of paying “user fees” for actions and services that are rightly considered core duties and responsibilities of tax administration officials, the financial burden and consequence of pay-to-play becomes even greater. Fundamental rights are now up for sale.**

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account will not provide for the kind of discussion necessary to ensure the IRS understands the details of the taxpayer’s circumstances, or whether the taxpayer understands what the IRS is telling him or her. Alternatively, the taxpayer will have to pay a tax professional or purchase a tax software add-on for services the taxpayer previously received for free from the government in exchange for his willingness to cooperate and comply with the tax laws.

What is being lost in this vision of the future is the interest in and relationship with actual taxpayers — a dialogue with taxpayers. The IRS is designing its system so it can deal with taxpayers *en masse*. I understand how budget and workload constraints could drive the IRS to adopt this approach. In fact, the IRS performs “mass processing” responsibilities well — it will likely have processed about 150 million individual income tax returns, almost 11 million business entity returns, and over 2.1 billion information returns last year.<sup>22</sup> But *taxpayers* are not returns — they are *people* (or businesses run by people). If the *taxpayer* has a problem or needs some particular information, that’s where the system (and the vision) breaks down. That taxpayer in the future will have to undertake “self-service” or obtain “for-fee” third-party assistance.

This approach transforms our tax system into a pay-to-play system. Those who are sophisticated enough to understand their tax problem or their tax needs and can navigate the self-help options well enough to protect their rights will be able to do so. Those who have the ability to pay a third party to navigate the IRS and protect their rights will do so. But for those who have neither the expertise, the time, nor the resources to navigate these options — they will be up a creek. They will make mistakes with self-help; they will agree to assessments and adjustments they never should; and they will forfeit significant due process protections like the right to go to the United States Tax Court or have a Collection Due Process hearing — all because they can’t talk with an IRS employee about their situation or because they can’t afford to pay someone to help them. This creates a two-class tax system — those who can pay and those who can’t. It undermines the fundamental *right to a fair and just tax system*. When you add on the additional burden of paying “user fees” for actions and services that are rightly considered core duties and responsibilities of tax administration officials, the financial burden and consequence of pay-to-play becomes even greater. Fundamental rights are now up for sale.<sup>23</sup>

### **An Online Account Will Be Helpful But Comes With Significant Risks and Is No Replacement for Person-to-Person Interaction**

I am fully in support of robust online services. Since 2009, I have been calling for the IRS to create online taxpayer accounts with full information about a taxpayer’s tax returns, with the ability to export W-2 and 1099 information to software programs, check on the status of return and refund processing, correspondence, and other account transactions, and receive electronic acknowledgements. I also support Circular 230 tax professionals’ and preparers’ access to those accounts, with proper taxpayer authorization and so long as the taxpayer is informed of his right to receive, electronically or otherwise, notification of

22 IRS Pub. 6187, *Calendar Year Projections of Returns by Major Processing Category* (Fall 2015); IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2015-2022* (Fall 2015); IRS Pub. 6961, *Calendar Year Projections of Withholding and Information Return Documents for the United States and IRS Campuses* (2015 Update).

23 See Most Serious Problem: *IRS User Fees: The IRS May Adopt User Fees to Fill Funding Gaps Without Fully Considering Taxpayer Burden and the Impact on Voluntary Compliance*, *infra*.

every online transaction made on his or her behalf. A well-designed taxpayer account will send due date notifications and updates on relevant current guidance. It will give taxpayers and their representatives the ability to communicate by email, to schedule appointments for phone conferences with the IRS, and to conduct virtual face-to-face conferences via computer.

But when you expand that access to unregulated preparers or to other third parties, I have significant concerns. We already see the problems in this population of preparers relating to the Earned Income Tax Credit (EITC),<sup>24</sup> where certain unregulated, untrained preparers prey on vulnerable taxpayers.<sup>25</sup> Why would we want to give these preparers even more access to taxpayer information? And yet, if we don't provide these preparers access to taxpayer accounts, it is very likely the tens of millions of taxpayers who use these preparers won't be able or won't want to utilize their own online accounts, thereby carving a big hole in the IRS's online strategy. Thus, through its single-minded emphasis on online accounts, the IRS creates a situation where it will face enormous pressure to open up taxpayer account access to all unregulated return preparers.

Moreover, not every activity can or should be done online. Many things relating to tax require a conversation. People want to talk about the things that matter to them. And few things matter more to people than talking about what is going to happen to their money.

### **Less Secrecy and More Transparency: The IRS Needs to Start Its Future State Visions Now by Engaging With Taxpayers About Its Proposals and Plans**

What is driving the IRS to think this way and go down this path of a two-class tax system? To some extent, the IRS is a victim of its own apparent efficiency at moving masses of data and work, as evidenced by the fact that Congress has continued to hand it major new programs to administer including the Patient Protection and Affordable Care Act (ACA)<sup>26</sup> and the Foreign Account Tax Compliance Act (FATCA).<sup>27</sup> After five years of overall budget decreases, the IRS FY 2016 budget provides for much needed increases in taxpayer service funding, but it still leaves the IRS budget almost 19 percent below its FY 2010 funding level in inflation-adjusted terms,<sup>28</sup> and it does not even begin to account for the additional costs the IRS incurred to implement the ACA and FATCA.

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24 See IRC § 32.

25 See Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*, *infra*.

26 Pub. L. No. 111-148, 124 Stat. 119 (2010). For detailed discussion of current issues in ACA administration, see Most Serious Problem: *Affordable Care Act (ACA) – Business: The IRS Faces Challenges in Implementing the Employer Provisions of the ACA While Protecting Taxpayer Rights and Minimizing Burden*, *infra*; Most Serious Problem: *Affordable Care Act – Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *infra*; Legislative Recommendation: *Affordable Care Act Information Reporting: Allow Taxpayer Identification Number Matching for Filers of Information Returns Under IRC §§ 6055 and 6056*, *infra*.

27 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010). For detailed discussion of our concerns regarding IRS FATCA implementation, see Most Serious Problem: *International Taxpayer Service: The IRS's Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*, *infra*; Legislative Recommendation: *Foreign Account Reporting: Eliminate Duplicative Reporting of Certain Foreign Financial Assets and Adopt a Same-Country Exception for Reporting Financial Assets Held in the Country in which a U.S. Taxpayer Is a Bona Fide Resident*, *infra*; Legislative Recommendation: *Chapter 3 and Chapter 4 Credits and Refunds: Protect Taxpayer Rights by Aligning the Rules Governing Credits and Refunds for Domestic and International Withholding*, *infra*.

28 In FY 2010, the agency's appropriated budget stood at \$12.1 billion. In FY 2016, its budget was set at \$11.2 billion, a reduction of nearly eight percent over the six-year period. Inflation over the same period is estimated at nearly 11 percent. See Office of Management and Budget, *Fiscal Year 2016 Budget of the U.S. Government, Historical Tables*, Table 10.1 (showing Gross Domestic Product (GDP) and year-to-year increases in the GDP), available at <https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/hist.pdf>.

In this environment of more work and inadequate funding, it is easy to bash the IRS. This bashing, in turn, can produce a bunker mentality in the IRS that makes it wary of sharing things with the public until they are absolutely finalized.<sup>29</sup> But that means the IRS will almost certainly miss things and get things wrong, precisely because it hasn't engaged the public and floated proposals publicly before they become set in stone.<sup>30</sup>

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**This bashing, in turn, can produce a bunker mentality in the IRS that makes it wary of sharing things with the public until they are absolutely finalized. But that means the IRS will almost certainly miss things and get things wrong, precisely because it hasn't engaged the public and floated proposals publicly before they become set in stone.**

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For any vision of the future to work, the IRS needs to engage taxpayers in the process. Taxpayers, in turn, need to speak up, get engaged, and hold the IRS accountable for responding to their needs. They need to contact their representatives in Congress and explain to them in real terms what it is like to interact with the IRS — the good and the bad. Tax professionals need to insist on a dialogue with the tax agency and push, push, push for greater transparency. They need to explain to their elected representatives why the current trajectory in tax administration is bad for tax compliance and just what it means for the representatives' constituents. Most importantly, Congress needs to assert its oversight authority and insist that the IRS come now, sooner not later, to explain the specifics of its future state vision. And those same hearings should include representatives of taxpayer segments as well as tax professionals. It is important that these hearings be kept separate from the hearings Congress has conducted in recent years on actual or perceived IRS shortcomings. Developing a consensus about the future state vision for our nation's tax system requires a single-minded focus on assessing the objectives of the tax system, what taxpayers need to comply with their tax obligations, and how to balance competing objectives. Finally, I believe the IRS should put its plan for the future out to the public for notice and comment.

Now, here is what I am going to do in 2016 to further the discussion of the IRS future state vision and to ensure that U.S. taxpayers have a voice in the process. I will be going around the country and holding public hearings on this topic. I will invite members of Congress and representatives of different taxpayer populations and stakeholders to join me so we can consider diverse viewpoints, and gather suggestions and descriptions of taxpayers' needs.

I am also going to highlight why taxpayers should care about what kind of IRS we have. There is no other federal agency that interacts as often with United States citizens and residents (and increasingly, non-residents). It is in taxpayers' best interests that they speak up about what kind and manner of assistance they need from the tax agency.

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29 Indeed, as we obtained information from the IRS to produce this Annual Report to Congress, the IRS has asserted that numerous data points and documents we intended to include in the report are "official use only" and may not be made public. Never before has the IRS made this assertion in so many instances, and never before have we ultimately failed to come to agreement on some disputed items. To avoid the risk my staff or I could be subject to disciplinary action for unauthorized disclosure, we have been forced to redact portions of text in some sections, and we have omitted relevant information in others.

See, e.g., Most Serious Problem: *IRS User Fees: The IRS May Adopt User Fees to Fill Funding Gaps Without Fully Considering Taxpayer Burden and the Impact on Voluntary Compliance*, *infra*; Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*, *infra*.

30 One area in which the IRS is sharing its vision of the future is its plans to reorganize the Large Business & International (LB&I) Operating Division. Senior IRS officials have discussed and shared materials about the reorganization at several practitioner meetings in recent months. While this is to be commended, I note that LB&I caters to the part of the taxpayer population that can "pay to play" and expects (and receives) concierge-level service. No such plans have been shared about the IRS future state plans for the approximately 150 million individual taxpayers, much less the approximately 54 million small business taxpayers.

### Conclusion

Every day, the IRS faces the daunting task of juggling an increasing and diverse workload involving both revenue collection and benefits payments, with the relentless demands of doing everything in as cost-efficient a manner possible. But for the IRS to do its job well, it must start from the perspective of what government is about — namely, it is of the people, by the people, and for the people. The government is funded by taxes paid by the people. Therefore, the future state vision of the IRS needs to be designed around the needs of the people. If it is, it will be effective and efficient. Most importantly, it will be trusted by the people. As always, I look forward to working with Congress and the IRS to make this so.

Respectfully submitted,



Nina E. Olson  
National Taxpayer Advocate  
31 December 2015

## TAXPAYER RIGHTS ASSESSMENT: IRS Performance Measures and Data Relating to Taxpayer Rights

In the 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that “...provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance.”<sup>31</sup>

On June 10, 2014, the IRS adopted a Taxpayer Bill of Rights (TBOR), a list of ten rights that the National Taxpayer Advocate recommended to help taxpayers and IRS employees alike gain a better understanding of the dozens of discrete taxpayer rights scattered throughout the multi-million word Internal Revenue Code.<sup>32</sup> While this was a significant achievement for increasing taxpayers’ awareness of their rights, and an important first step toward integrating taxpayer rights into all aspects of tax administration, more can be done. The *Taxpayer Rights Assessment* contains selected performance measures and data organized by the ten taxpayer rights and is one step integrating taxpayer rights into tax administration.

This *Taxpayer Rights Assessment* is a work in progress. The following data provide insights into IRS performance; however, they are by no means comprehensive. In some instances, data is not readily available. In other instances we may not yet have sufficient measures in place to address specific taxpayer rights. And, despite what the numbers may show, we must be concerned for those taxpayers who still lack access to services and quality service even when performance metrics are increasing. This *Taxpayer Rights Assessment* will grow and evolve over time as data becomes available and new concerns emerge.

- 1. THE RIGHT TO BE INFORMED** – Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

Measure/Indicator	Fiscal Year (FY) 2014	FY 2015
Individual Correspondence Volume (adjustments) <sup>a</sup>	5,700,132	4,957,442
Average cycle time to work Individual Master File (IMF) Correspondence (non-Identity Theft) <sup>b</sup>	80 days	80 days
Inventory Overage (non-Identity Theft) <sup>c</sup>	67.0%	60.5%
Average cycle time to work IMF Correspondence (Identity Theft) <sup>d</sup>	106 days	80 days
Inventory Overage (Identity Theft) <sup>e</sup>	4.0%	0.7%
Business Correspondence Volume (adjustments) <sup>f</sup>	3,471,571	2,952,329
Average cycle time to work BMF Correspondence <sup>g</sup>	54 days	46 days
Inventory Overage <sup>h</sup>	17.5%	17.3%
Total Correspondence (all types)	TBD	TBD
Quality of IRS Forms & Publications	TBD	TBD
IRS.gov Web Page Ease of Use	TBD	TBD
IRS Outreach	TBD	TBD

31 See National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface: *Taxpayer Service Is Not an Isolated Function But Must Be Incorporated Throughout All IRS Activities, Including Enforcement*).

32 IRS, IR-2014-72, *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to Be Highlighted on IRS.gov, in Publication 1* (June 10, 2014).

- a IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2014 - FY 2015). These data on correspondence are also repeated under Right 4 – *The Right to Challenge the IRS’s Position and Be Heard*.
- b IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2015). In the 2014 Annual Report to Congress, we reported a different metric – the Average Days of Inventory – which projects the number of days to work the inventory based on the current rate of closures. This new metric reflects the average number of days the IRS actually took to work correspondence.
- c IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2014* (week ending Sept. 27, 2014); IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2015* (week ending Sept. 26, 2015). Beginning in FY 2015, the IRS began to report separate figures for Identity Theft correspondence. The figure we reported in the 2014 Annual Report to Congress for IMF correspondence overall was 63.6 percent.
- d IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2015). In the 2014 Annual Report to Congress, we reported a different metric – the Average Days of Inventory – which projects the number of days to work the inventory based on the current rate of closures. This new metric reflects the average number of days the IRS actually took to work correspondence.
- e IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2014* (week ending Sept. 27, 2014); IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2015* (week ending Sept. 26, 2015). Beginning in FY 2015, the IRS began to report separate figures for Identity Theft correspondence. The figure we reported in the 2014 Annual Report to Congress for IMF correspondence overall was 63.6 percent.
- f IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2014 - FY 2015).
- g IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2015). In the 2014 Annual Report to Congress, we reported a different metric – the Average Days of Inventory – which projects the number of days to work the inventory based on the current rate of closures. This new metric reflects the average number of days the IRS actually took to work correspondence.
- h IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2014* (week ending Sept. 27, 2014); IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2015* (week ending Sept. 26, 2015).

**2. THE RIGHT TO QUALITY SERVICE** – Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

Measure/Indicator	FY 2014	FY 2015
Number of Returns Filed (projected, all types) <sup>a</sup>	242,404,425	246,523,200
Total Individual Income Tax Returns <sup>b</sup>	147,444,789	149,288,400
E-file Receipts (Received by 11/21/14, 11/20/15) <sup>c</sup>	125,821,000	128,784,000
E-file: Tax Professional <sup>d</sup>	62%	61%
E-file: Self Prepared <sup>e</sup>	38%	39%
<b>Returns Prepared by:</b>		
VITA/TCE/AARP <sup>f</sup>	3,322,582	3,519,006
Free File Consortium <sup>g</sup>	2,406,465	2,588,934
Fillable Forms <sup>h</sup>	478,501	355,080
IRS Taxpayer Assistance Centers (TACs) <sup>i</sup>	376	366
Number of Taxpayer Assistance (“Walk-In”) Centers <sup>j</sup>	382	380
Number of TAC Contacts <sup>k</sup>	5,477,291	5,643,772
Total Calls to IRS <sup>l</sup>	100,667,411	116,679,405
Number of Attempted Calls to IRS Customer Service Lines <sup>m</sup>	86,171,857	101,507,150
Toll Free: Percentage of calls answered <sup>n</sup> (LOS)	64.4%	38.1%
Toll Free: Average Speed of Answer <sup>o</sup>	19.6 minutes	30.5 minutes
NTA Toll Free: Percentage of calls answered (LOS)	68.9%	43.7%
NTA Toll Free: Average Speed of Answer <sup>p</sup>	7.0 minutes	16.2 minutes
Practitioner Priority: Percentage of calls answered (LOS)	70.4%	47.6%
Practitioner Priority: Average Speed of Answer <sup>q</sup>	27.4 minutes	46.6 minutes
Tax Exempt/Government Entities Percentage of calls answered <sup>r</sup> (LOS)	67.6%	60.2%
Tax Exempt/Government Entities: Average Speed of Answer <sup>s</sup>	18.7 minutes	23.4 minutes
Toll Free Customer Satisfaction <sup>t</sup>	89.0%	87.0%
Awareness of Service (or utilization)	TBD	TBD
IRS Issue Resolution – Percentage of taxpayers who had their issue resolved as a result of the service they received	TBD	TBD
Taxpayer Issue Resolution – Percentage of taxpayers who reported their issue was resolved after receiving service	TBD	TBD

- a IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2015-2022* (June 2015), at 4. The FY 2014 figure is actual and is updated from the figure reported in the 2014 Annual Report to Congress. The number of returns and related metrics are proxies for IRS workload and provide context for the environment in which taxpayers seek Quality Service and other rights.
- b IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2015-2022* (June 2015), at 4. The FY 2014 figure is actual, and is updated from the figure reported in the 2014 Annual Report to Congress.
- c IRS, Filing Season Statistics, available at <https://www.irs.gov/uac/Newsroom/Filing-Season-Statistics-for-Week-Ending-November-20-2015> (last visited Dec. 5, 2015).
- d *Id.*
- e *Id.*
- f IRS, Compliance Data Warehouse, Electronic Tax Administration Marketing Database. We used Tax Year 2013 (returns filed in FY 2014) for the FY 2014 data point and Tax Year 2014 (returns filed in FY 2015) for the FY 2015 data point. Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly, and AARP Tax-Aide programs.
- g *Id.*
- h *Id.*
- i IRS, E-File Reports, *Field Assistance Report, Current Year Accepted* (Jan. – Dec. 2015).
- j Information received from Senior Advisor, Wage and Investment Division (W&I) (Dec. 23, 2104). Three hundred eighty-nine Taxpayer Assistance Centers were open during the filing season, and 382 were open at the end of the fiscal year. FY 2015 data from Selected Taxpayer Assistance Centers Were Professional and Organized, and Sensitive Information and Equipment Were Properly Secured, TIGTA 2016-IE-R001 (Oct. 2, 2015)
- k W&I, Business Performance Review (BPR), 4th Quarter, FY 2015 (Nov. 2, 2015) at 7. The 2014 figure is updated from the figure reported in the 2014 Annual Report to Congress.
- l IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015; report generated Dec. 19, 2015).
- m IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2014; report generated Dec. 19, 2015). Number of calls to Accounts Management (formerly Customer Services, now Accounts Management) - Sum of 30 lines (0217, 1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 1778, 9887, 9982, 2942, 4184, 7388, 0452, 0352, 7451, 9946, 5215, 3536, 2050, 4017, 2060, 4778, 4259, 8482, 8775, 5500 and 4490). The IRS determines its level of service based on calls to Accounts Management, not total calls.
- n IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2014; report generated Oct. 16, 2014). Calls answered include reaching live assistor or selecting options to hear automated information messages.
- o *Id.*
- p *Id.*
- q *Id.*
- r *Id.*
- s *Id.*
- t W&I, BPR, 4th Quarter, FY 2015 (Nov. 2, 2015), at 13.

**3. THE RIGHT TO PAY NO MORE THAN THE CORRECT AMOUNT OF TAX** – Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

Measure/Indicator	FY 2014	FY 2015
Toll-Free Tax Law Accuracy <sup>a</sup>	95.0%	95.0%
Toll-Free Accounts Accuracy <sup>b</sup>	96.2%	95.5%
Scope of Tax Law Questions Answered	TBD	TBD
<b>Correspondence Examinations (Form 1040 Series)</b>		
No change rate <sup>c</sup>	17.3%	17.3%
Agreed rate <sup>d</sup>	17.2%	16.3%
Non-response rate <sup>e</sup>	44.4%	48.3%
Percentage of cases appealed	TBD	TBD
<b>Field Examinations (Form 1040 Series)</b>		
No change rate <sup>f</sup>	15.5%	15.3%
Agreed rate <sup>g</sup>	46.6%	45.7%
Non-response rate <sup>h</sup>	0.3%	0.3%
Percentage of cases appealed	TBD	TBD

Office Examinations		
No change rate <sup>i</sup>	13.7%	13.5%
Agreed rate <sup>j</sup>	45.0%	44.7%
Non-response rate <sup>k</sup>	19.0%	19.8%
Percentage of cases appealed	TBD	TBD
Math Error Adjustments	TBD	TBD
Math Error Abatements	TBD	TBD
Number of Statutory Notices of Deficiency Issued	TBD	TBD
Number of Statutory Notices of Deficiency Appealed	TBD	TBD
Number of Collection Appeals Program Conferences	TBD	TBD
Number of Collection Appeals Program Conferences Reversing IRS position	TBD	TBD
Number of Collection Due Process Conferences	TBD	TBD
Number of Collection Due Process Conferences Reversing IRS position	TBD	TBD

a W&I, BPR, 4th Quarter, FY 2015 (Nov. 2, 2015), at 4.

b *Id.*

c IRS, Audit Information Management System, Closed Case Database.

d *Id.*

e *Id.*

f *Id.*

g *Id.*

h *Id.*

i *Id.*

j *Id.*

k *Id.*

- 4. THE RIGHT TO CHALLENGE THE IRS'S POSITION AND BE HEARD** – Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

Measure/Indicator	FY 2014	FY 2015
Individual Correspondence Volume (adjustments) <sup>a</sup>	5,700,132	4,957,442
Average cycle time to work Individual Master File (IMF) Correspondence (non-Identity Theft) <sup>b</sup>	80 days	80 days
Inventory Overage (non-Identity Theft) <sup>c</sup>	67.0%	60.5%
Average cycle time to work IMF Correspondence (Identity Theft) <sup>d</sup>	106 days	80 days
Inventory Overage (Identity Theft) <sup>e</sup>	4.0%	0.7%
Business Correspondence Volume (adjustments) <sup>f</sup>	3,471,571	2,952,329
Average cycle time to work BMF Correspondence <sup>g</sup>	54 days	46 days
Inventory Overage <sup>h</sup>	17.5%	17.3%
Percentage of Math Error Adjustments Abated	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD
Number of Collection Appeal Program Conferences Requested by Taxpayers <sup>i</sup>	TBD	TBD
Percentage of CAP Conferences that Reversed the IRS Position	TBD	TBD
Number of Collection Due Process Hearings Requested by Taxpayers	TBD	TBD
Percentage of Collection Due Process Hearings that Reversed the IRS Position	TBD	TBD

- a IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2014 - FY 2015). These data on correspondence are also listed under Right 1 - *The Right to Be Informed*.
- b IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2015). In the 2014 Annual Report to Congress, we reported a different metric – the Average Days of Inventory – which projects the number of days to work the inventory based on the current rate of closures. This new metric reflects the average number of days the IRS actually took to work correspondence.
- c IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2014* (week ending Sept. 27, 2014); IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2015* (week ending Sept. 26, 2015). Beginning in FY 2015, the IRS began to report separate figures for Identity Theft correspondence. The figure we reported in the 2014 Annual Report to Congress for IMF correspondence overall was 63.6 percent.
- d IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2015). In the 2014 Annual Report to Congress, we reported a different metric – the Average Days of Inventory – which projects the number of days to work the inventory based on the current rate of closures. This new metric reflects the average number of days the IRS actually took to work correspondence.
- e IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2014* (week ending Sept. 27, 2014); IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2015* (week ending Sept. 26, 2015). Beginning in FY 2015, the IRS began to report separate figures for Identity Theft correspondence. The figure we reported in the 2014 Annual Report to Congress for IMF correspondence overall was 63.6 percent.
- f IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2014 - FY 2015).
- g IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2015). In the 2014 Annual Report to Congress, we reported a different metric – the Average Days of Inventory – which projects the number of days to work the inventory based on the current rate of closures. This new metric reflects the average number of days the IRS actually took to work correspondence.
- h IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2014* (week ending Sept. 27, 2014); IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2015* (week ending Sept. 26, 2015).
- i Taxpayers may request a Collection Appeals Process review as the result of IRS actions such filing a Notice of Federal Tax Lien, an IRS levy or seizure of property, and termination, rejection, or modification of an installment agreement. See IRS Pub. 1660, *Collection Appeal Rights*.

**5. THE RIGHT TO APPEAL AN IRS DECISION IN AN INDEPENDENT FORUM** – Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals’ decision. Taxpayers generally have the right to take their cases to court.

Measure/Indicator	FY 2014	FY 2015
Number of Cases Appealed <sup>a</sup>	113,608	113,870
Appeals Staffing (On-rolls) <sup>b</sup>	1,708	1,569
Number of States without an Appeals or Settlement Officer <sup>c</sup>	12	11
Customer Satisfaction of service in Appeals <sup>d</sup>	68%	TBD
Average Days in Appeals to Resolution	TBD	TBD
Percentage of cases appealed	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD

a Office of Appeals, BPR, 4th Quarter FY 2015 (Nov. 16, 2015), at 8.

b Office of Appeals, BPR, 4th Quarter FY 2015 (Nov. 16, 2015), at 10. The 2014 figure is updated from the figure reported in the 2014 Annual Report to Congress.

c IRS, Human Resources Reporting Center, *available* at <https://persinfo.web.irs.gov/posrpt.htm>. Employee Position (OF8) Listing for weeks ending October 4, 2015, and October 3, 2015.

d Office of Appeals, BPR, 4th Quarter FY 2015 (Nov. 16, 2015), at 6.

- 6. THE RIGHT TO FINALITY** – Taxpayers have the right to know the maximum amount of time they have to challenge the IRS’s position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

Measure/Indicator	FY 2014	FY 2015
Average Days to Complete Correspondence Examination (non-EITC) <sup>a</sup>	225 days	231 days
Average Days to Complete Correspondence Examination (EITC) <sup>b</sup>	243 days	221 days
Average Days to Reach Determination on Applications for Exempt Status <sup>c</sup>	291 days	83 days
Average Days for Exempt Organization Function to Respond to Correspondence <sup>d</sup>	207 days	175 days
Percentage of calls/letters/issues resolve in a single 2-way communication (single call, single meeting, or single exchange of correspondence)	TBD	TBD

a W&I, Business Performance Review, 4th Quarter, FY2015 (Nov. 2, 2015), at 8.

b *Id.*

c Tax Exempt and Government Entities (TE/GE), Business Performance Review, 4th Quarter FY 2015 (Dec. 9, 2015), at 17. The 2014 figure is updated from the figure reported in the 2014 Annual Report to Congress.

d TE/GE, Business Performance Review, 4th Quarter FY 2015 (Dec. 9, 2015), at 19. The 2014 figure is updated from the figure reported in the 2014 Annual Report to Congress.

- 7. THE RIGHT TO PRIVACY** – The right to privacy goes to the right to be free from unreasonable searches and seizures and that IRS actions would be no more intrusive than necessary. Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

Measure/Indicator	FY 2014	FY 2015
Number (or percentage) of Collection Due Process cases where IRS cited for Abuse of Discretion	TBD	TBD
Number of Offers in Compromise Submitted using ‘Effective Tax Administration’ as Basis	TBD	TBD
Percentage of Offers in Compromise Accepted that used ‘Effective Tax Administration’ as Basis	TBD	TBD
Number of cases where taxpayer received repayment of attorney fees as result of final judgment.	TBD	TBD

- 8. THE RIGHT TO CONFIDENTIALITY** – Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

Measure/Indicator	FY 2014	FY 2015
Number of Unauthorized Access of Taxpayer Account (UNAX) Violations	TBD	TBD
Percentage of UNAX Violations Determined to be Inadvertent	TBD	TBD
Percentage of UNAX Violations Determined that Resulted in Discipline or Removal	TBD	TBD

**9. THE RIGHT TO RETAIN REPRESENTATION** – Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

Measure/Indicator	FY 2014	FY 2015
Percentage of Power of Attorney Requests Overage <sup>a</sup>	0%	0%
Number of Low Income Taxpayer Clinics Funded <sup>b</sup>	131	132
Funds Appropriated for Low Income Tax Clinics <sup>c</sup>	\$10 million	\$10.3 million
Number of States and other jurisdictions with a Low Income Tax Clinic <sup>d</sup>	48	50
Number of Low Income Tax Clinic Volunteer Hours <sup>e</sup>	60,229	54,164

a IRS, JOC, *Customer Account Services, Accounts Management Paper Inventory Inventory Reports*, weeks ending 9/27/2014 and 9/26/2015.

b IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2014 and Dec. 2015).

c Consolidated Appropriations Act, Pub. L. No. 113-76, enacted Jan. 17, 2014.

d Includes states and the District of Columbia that have at least one Low Income Tax Clinic. IRS Pub. 5066, *Low Income Tax Clinics Report* (Dec. 2014 and Dec. 2015).

e IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2014 and Dec. 2015).

**10. THE RIGHT TO A FAIR AND JUST TAX SYSTEM** – Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

Measure/Indicator	FY 2014	FY 2015
Offer in Compromise: Number of Offers Submitted <sup>a</sup>	67,935	66,600
Offer in Compromise: Percentage of Offers Accepted <sup>b</sup>	41.9%	42.5%
Installment Agreements: Number of Individual & Business IAs <sup>c</sup>	3,011,636	2,986,121
Streamlined Installment Agreements Number of Individual & Business IAs <sup>d</sup>	2,857,043	2,567,623
Installment Agreements (Cff): Number of Individual & Business IAs <sup>e</sup>	52,619	52,053
Streamlined Installment Agreements (Cff): Number of Individual & Business IAs <sup>f</sup>	10,680	10,679
Number of OICs Accepted per Revenue Officer <sup>g</sup>	6.7	7.4
Number of IAs Accepted per Revenue Officer <sup>h</sup>	13.1	14.0
Percentage of Cases in the Queue (Taxpayers) <sup>i</sup>	15.6%	15.7%
Percentage of cases in the Queue (Modules)	25%	24.7%
Percentage of TDAs reported Currently Not Collectible - Tolerance <sup>j</sup>	18.2%	16.3%
Age of Delinquencies in the Queue <sup>k</sup>	4.4 years	4.5 years
Percentage of Modules in Queue prior to three tax years ago	80.2%	79.2%
Percentage of cases where the taxpayer is fully compliant after five years <sup>l</sup>	42%	44%

a IRS, Collection Activity Report No. 5000-108, FY 2014 (Sep. 29, 2014).

b *Id.*

c IRS, Collection Activity Report No. 5000-6, FY 2014 (Sep. 29, 2014).

d *Id.*

e *Id.*

f *Id.*

g *Id.* See also IRS Human Resources Reporting Center – number of revenue officers in SB/SE as of the end of FY 2014 and FY 2015 (pay period 19).

h *Id.*

i IRS, Collection Activity Report No. 5000-2, FY 2014 (Sep. 29, 2014).

j *Id.*

k *Id.*

l Calculation by TAS Research. Percentage of taxpayers with tax delinquent accounts in 2009 and 2010, respectively, and who have no new delinquencies five years later. IRS, IMF.

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## THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2015, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 24 such problems.

### IRS FUTURE STATE VISION: IMPLICATIONS FOR TODAY AND TOMORROW

#### **MSP #1 TAXPAYER SERVICE: The IRS Has Developed a Comprehensive “Future State” Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet**

##### **Problem**

During the past year-and-a-half, the IRS has developed a “future state” plan that details how the agency will operate in five years. There are many positive components of the plan, including the goal of creating online accounts through which taxpayers will be able to obtain information and interact with the IRS.

However, the plan raises at least two significant concerns. First, implicit in the plan — and explicit in internal discussions — is an intention on the part of the IRS to substantially reduce telephone and face-to-face service. Second, to the extent taxpayers require help, the IRS is developing procedures to enable third parties like tax return preparers and tax software companies to provide it — an approach that will increase taxpayer compliance costs.

##### **Analysis**

Taxpayer demand for IRS services and assistance is high and has remained so for many years. The IRS has received more than 100 million taxpayer calls and five million taxpayer visits in every year since FY 2008. Online accounts are unlikely to reduce taxpayer phone calls and visits significantly for several reasons, including that millions of taxpayers do not have Internet access, millions of taxpayers with Internet access do not feel comfortable trying to resolve important financial matters over the Internet, and many taxpayer problems are not “cookie cutter,” thus requiring a degree of back-and-forth discussion that is better suited for conversation and that taxpayers will insist upon.

If the IRS substantially reduces the opportunity for taxpayers to talk with IRS employees, many taxpayers will find it much harder to resolve their problems and will have to pay third parties to assist them. This will generate additional taxpayer frustration with the IRS. As a result, confidence in the fairness of the tax system may erode, and taxpayer frustration and alienation may lead over time to a lower rate of voluntary compliance.

Because the IRS’s future-state plan has the potential to bring about a fundamental transformation in the way the government treats its taxpayers and interacts with them, we recommended in June that the IRS make its plan public and seek comments from taxpayers, practitioners, and others. To date, the IRS has not done so.

**Recommendations**

The National Taxpayer Advocate recommends (1) that the IRS immediately publish its plan and solicit public comments and (2) that Congress hold hearings during the next few months on the future state of IRS operations. These hearings should seek testimony from groups representing the interests of individual taxpayers (including elderly, low income, disabled, and limited English proficiency taxpayers), sole proprietors, other small businesses, and Circular 230 practitioners and unenrolled tax return preparers. They should also include witnesses who can address the additional compliance burden the plan will impose on various categories of taxpayers and the likely impact of the plan on the overall rate of voluntary tax compliance.

## MSP #2 **IRS USER FEES: The IRS May Adopt User Fees to Fill Funding Gaps Without Fully Considering Taxpayer Burden and the Impact on Voluntary Compliance**

### Problem

The IRS is actively considering user fee increases that would replace its reduced appropriation. User fees that seem reasonable to the IRS in a vacuum may seem outrageous to taxpayers when added to the costs of recordkeeping, filing and paying taxes, and paying professionals for help in navigating complicated rules and procedures that the government created. If user fees discourage taxpayers from using IRS services, they can be inconsistent with the IRS's service-oriented mission, reduce voluntary compliance, and erode taxpayer rights. However, the Internal Revenue Manual (IRM) does not require the IRS to consider these items. As a result, the IRS may increase user fees without fully considering the consequences.

### Analysis

The IRS's mission is to “[P]rovide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.” It has also adopted a Taxpayer Bill of Rights, including the *rights to quality service, privacy, and a fair and just tax system*. The “right” to quality service may be inconsistent with requiring taxpayers to pay a fee for service. If some are unable to pay, IRS enforcement may be more intrusive than necessary, eroding the *right to privacy*. In such cases, the fee may also erode the *right to a fair and just tax system*. In addition, if a fee discourages taxpayers from using services that promote voluntary compliance, it may reduce compliance.

In 2007, the National Taxpayer Advocate reported that the IRS did not have a consistent methodology for determining when to charge a fee or for estimating the effect of the fee on demand for service. Since then it updated the IRM, but still does not require employees to consider the effect of user fees on taxpayer rights, the IRS mission, or voluntary compliance, or to estimate their effect on demand for service or taxpayer burden. As a result, the IRS is considering user fee proposals without sufficient regard for these effects. It may consider them in some cases and not others.

### Recommendations

The National Taxpayer Advocate recommends that the IRS update the IRM to avoid fees that would have significant negative effects on taxpayer burden, the IRS's mission, voluntary compliance, or taxpayer rights. To ensure the IRS's analysis is informed, it should estimate the effects of any proposed fee, publish its analysis along with a detailed explanation showing the basis for it, and only implement the fee after it revises its analysis to address comments from stakeholders.

### **MSP #3 FORM 1023-EZ: Recognition As a Tax-Exempt Organization Is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to Be Taxable**

#### **Problem**

Since July 2014, the Tax Exempt and Government Entities division (TE/GE) has addressed backlogs in its inventory of applications for tax-exempt status by allowing certain organizations to use Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. Form 1023-EZ adopts a “checkbox approach,” requiring applicants merely to attest, rather than demonstrate, that they meet fundamental aspects of qualification as an exempt entity. Form 1023-EZ does not solicit any narrative of the organization’s activities, any financial data, any substantiating documents, or any explanatory material. With the adoption of Form 1023-EZ, the IRS effectively abdicated its responsibility to *determine* whether an organization is organized and operated for an exempt purpose. TE/GE intends to address the noncompliance it helped create by shifting more resources to audits.

#### **Analysis**

TE/GE’s Exempt Organization (EO) function approves 95 percent of applications submitted on Form 1023-EZ. EO’s own pre-determination review program shows that EO approves applications much less frequently — 77 percent of the time — when it reviews documents or basic information from the applicants, rather than relying only on the attestations contained in the form. EO rejects some applications simply because the applicant was not eligible to use Form 1023-EZ, but the pre-determination review also showed that almost 20 percent of Form 1023-EZ applicants, despite their attestations to the contrary, did not qualify for exempt status as a matter of law. These results are consistent with TAS’s analysis of a representative sample of Form 1023-EZ applicants that obtained exempt status, which showed that 37 percent of the organizations in the sample did not satisfy the legal requirements for exempt status. Often, a deficiency in the applicant’s organizing documents that prevented qualification as an Internal Revenue Code § 501(c)(3) organization could have easily been corrected had the applicant been advised of it.

#### **Recommendations**

The National Taxpayer Advocate recommends that the IRS revise Form 1023-EZ to require applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to submit their organizing documents. Form 1023-EZ should also require applicants to submit a description of their actual or planned activities and financial information such as past and projected revenues and expenses. The IRS should make a determination only after reviewing the application and these supporting materials. When the IRS identifies a deficiency in an applicant’s organizing documents, it should require the applicant to submit a certified copy of reformed articles before it confers exempt status.

## **MSP #4 REVENUE PROTECTION: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of “False Positives” Within the IRS’s Pre-Refund Wage Verification Program**

### **Problem**

The IRS uses the Pre-Refund Wage Verification Program (hereinafter — Income Wage Verification or IWV) to temporarily freeze an individual’s refund when it detects potentially false wages and withholding. The National Taxpayer Advocate first expressed concerns with the IRS’s inability to properly identify, process, and timely release refund freezes in 2003. Despite certain improvements, such as technological advances and procedural and policy changes, the IRS’s screening processes in this program continue to harm taxpayers with legitimate returns. The National Taxpayer Advocate acknowledges that any screening method will result in false positives but remains concerned that the IRS does not track the false positive rates for the IWV program, and thus, is unable to determine the precise filters or screens stopping legitimate refunds. Moreover, the IRS does not have adequate procedures to promptly review and adjust its fraud detection filters, rules, and models. Finally, taxpayers whose refunds the IWV program freezes cannot reach a live assistor in the Integrity & Verification Operation (IVO) unit. These shortcomings burden taxpayers whose legitimate refunds are substantially delayed. As a result, the taxpayers’ *rights to be informed, to quality service, to challenge the IRS’s position and be heard, to privacy, and to a fair and just tax system* are jeopardized.

### **Analysis**

TAS analysis of the population of taxpayers filing for tax year 2014, whose returns the Electronic Fraud Detection System (EFDS) selected for review in 2015, showed that nearly 180,000 such taxpayers who finally received their refunds experienced delays of nearly 18 weeks on average. EFDS had a “false positive” rate of almost 35 percent in FY 2015. In 2015, the IRS moved potential identity theft returns identified by EFDS from the IWV to the Taxpayer Protection Program (TPP) for processing. The TPP’s false positive rate jumped from 19.8 percent in calendar year (CY) 2014 to 36.2 percent in CY 2015, while the Level of Service (LOS) for taxpayers trying to contact the IRS to verify their identity plummeted — at one point during the peak of the filing season, the LOS was ten percent. The IRS also increased the testing of another application it uses to detect identity theft or fraud, the Return Review Program (RRP), which experienced an over 500 percent increase in stopping legitimate tax returns this year. Despite the IRS decreasing the workload in the IVO unit, which operates the IWV program, by 47 percent in CY 2015, TAS received 36,752 IWV cases in CY 2015, or nearly 15 percent more as compared to the prior year, making it the second most common reason taxpayers came to TAS. TAS provided full or partial relief for almost four out of five taxpayers who contacted TAS about delayed refunds flagged under the IWV program, spending an average of 8.2 weeks to resolve these cases.

### **Recommendations**

To address issues associated with the IWV Program, the National Taxpayer Advocate recommends that the IRS begin tracking the IWV false positive rates by model or filter during the filing season, perform regular global reviews, and quickly adapt filters, rules, and models based on levels of confidence in each; establish target false positive rates for each process and filter; collaborate with TAS on implementing the new legal requirement to file returns and statements related to employee wage information and nonemployee compensation on or before January 31 of the year following the calendar year to which such returns relate; reinstate the Pre-Refund Program Executive Steering Committee to coordinate policy and other servicewide processes and business rules and include TAS in the steering committees as a charter voting

member; create a sub-committee under the Business Rules and Requirements Management office with the authority to implement real-time modifications to screening rules and filters pertaining to tax fraud detection, resolution, and prevention, which directly affect RRP systems development, and include a TAS representative; and create a Taxpayer Call Area in IVO, which will include front-end outgoing verification calls to taxpayers from the IVO unit, and the answering of direct taxpayer calls about refunds.

## **MSP #5 TAXPAYER ACCESS TO ONLINE ACCOUNT SYSTEM: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online**

### **Problem**

The IRS is planning to develop an online taxpayer account system. We are pleased that the IRS is moving forward with plans to develop such a system, due to the benefits to both taxpayers and the IRS. However, the IRS cannot ignore the service needs of a significant portion of the taxpayer population who still require more personalized service options, such as face-to-face or telephone services, due to preference or lack of internet access. In addition, even the most technologically savvy taxpayers may at times need to use personal services because the issue they have is not conducive to resolve online. While in the current budget environment it is tempting to move taxpayer service toward superficially lower-cost self-assistance options, any efforts to significantly reduce personal service options may ultimately impair voluntary compliance and undermine the taxpayers' *right to quality service, right to be informed, and right to pay no more than the correct amount of tax.*

The National Taxpayer Advocate also remains concerned about the scope of the self-correction authority set forth in the draft IRS Concept of Operations (CONOPS). It is unclear if these corrections will constitute an amended return or if the original return remains unprocessed until corrected. These options have legal consequences to the taxpayer with potential negative impacts on taxpayer rights.

### **Analysis**

The IRS is planning to develop an online taxpayer account program which would enable taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates. It would also enable them to perform "self-correction" functions such as verifying return changes made by the IRS, updating or amending returns, and providing additional documents. Taxpayers with access to the system will be more informed about their tax situation and have the tools to interact with the IRS in a convenient manner. The IRS, in turn, may benefit from both reduced and more fruitful phone calls because many of the callers will be more prepared to discuss relevant issues or ask pointed questions due to the information available on the online account. However, the IRS should not drastically reduce face-to-face and telephone services as it focuses on the online account program. Studies have shown that a significant portion of taxpayers would still require these more personalized due to a variety of reasons. In fact, studies have shown that taxpayers prefer different service channels depending on the type of transaction they are conducting with the IRS.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS conduct a biennial nationwide survey of taxpayers to identify trends and determine the types of transactions or other activities taxpayers would be willing to conduct with the IRS digitally; conduct research to identify the taxpayer base who will utilize the online taxpayer account system, by type of transaction, also focusing on reasons for not using the program; incorporate into the CONOPS, budget initiatives, and in the strategic plan a recognition and plan for meeting the service needs of those taxpayers who are not likely to use online service offerings; and research taxpayer response to the necessary online account system cybersecurity and authentication measures.

## PROBLEMS THAT UNDERMINE TAXPAYER RIGHTS AND IMPOSE TAXPAYER BURDEN

### **MSP #6 PREPARER ACCESS TO ONLINE ACCOUNTS: Granting Uncredentialed Preparers Access to an Online Taxpayer Account System Could Create Security Risks and Harm Taxpayers**

#### **Problem**

The National Taxpayer Advocate has advocated for years that the IRS develop an online account system for taxpayers. The IRS has identified online account access as one of the top ten initiatives needed to achieve its compliance vision. Online account access would enable taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates. Despite the anticipated benefits of the system, the National Taxpayer Advocate is concerned that taxpayers will be harmed if the IRS does not restrict preparer access to the system to those preparers who are subject to IRS oversight under Circular 230. In addition, the IRS should clearly define the scope of preparers' access to online accounts and enable the taxpayer to maintain strict control over preparer authorizations. Finally, it is crucial that the IRS develop and implement procedures to ensure that preparers do not exceed their authority when accessing taxpayers' online accounts.

#### **Analysis**

The National Taxpayer Advocate is concerned that the IRS will expose taxpayers to potential harm due to incompetence or misconduct if it does not restrict access to those preparers subject to IRS oversight pursuant to Circular 230. Thus, the IRS should restrict preparer access to the online account to attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and preparers who have obtained a voluntary Annual Filing Season Program Record of Completion. Because a preparer's actions could severely prejudice the taxpayer's procedural rights, the taxpayer should be able to maintain strict control over exactly what the taxpayer authorizes the preparer to do on the taxpayer's behalf. In addition, because a taxpayer may be responsible for the preparer's actions, whether authorized or not, it is crucial that the taxpayer is aware of all the actions taken by the preparer on the taxpayer's online account. Further, if the IRS creates the online account system with blanket authorizations as the only available option, the IRS should mitigate the known risk of unauthorized actions. Accordingly, the system should alert the taxpayer whenever the preparer takes any type of action so that the taxpayer can take immediate steps to undo any unauthorized transactions. Finally, the IRS must develop a method to track preparer access and restrict all unauthorized activities.

#### **Recommendations**

The National Taxpayer Advocate recommends that the IRS limit preparer access to the taxpayer online account system to only those preparers subject to IRS oversight under Circular 230; enable the taxpayer to maintain strict control over preparer authorizations by checking boxes for each type of action the designated preparer can take on behalf of the taxpayer; develop procedures to automatically alert the taxpayer of any preparer activities and provide information on how to report any unauthorized access; and develop procedures to track preparer access to the taxpayer's online account and verify that the actions taken were authorized by the taxpayer.

## **MSP #7    INTERNATIONAL TAXPAYER SERVICE: The IRS's Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers**

### **Problem**

During late 2014 and 2015 the IRS eliminated the last four tax attaché posts abroad. International taxpayers now must either call an overwhelmed, tolled IRS telephone number in the United States or obtain information from irs.gov. Apart from the attachés, the only free option for taxpayers to ask a specific question and receive a response from an IRS employee was the Electronic Tax Law Assistance Program (ETLA), which the IRS terminated in October 2015. The IRS has shut itself off from international taxpayers with no way of knowing whether it is providing the service taxpayers need. Given the complexity of international tax rules and the potentially devastating penalties for even inadvertent noncompliance, the IRS's withdrawal of dialogue makes it more likely taxpayers will get it wrong.

### **Analysis**

The number of U.S. citizens living abroad continues to grow, from approximately 7.6 million in mid-2014 to about 8.7 million in mid-2015. The attachés were highly efficient and cost effective in assisting taxpayers abroad because they likely benefited many more taxpayers than just the ones who contacted them. In fiscal year 2014, approximately 5,442 taxpayers walked in to the London attaché office. In addition to providing information and personally assisting taxpayers, the attachés learned about the issues taxpayers found confusing, incorporating this into materials and sharing it with other IRS offices. ETLA provided a valuable avenue for international taxpayers to meaningfully interact with the IRS. This is evidenced by the recent increase in ETLA inquiries, with an average of almost 32,000 inquiries per year during the last four years, compared with an average of only about 13,500 inquiries per year during the prior four years. Further, ETLA inquiries from aliens and U.S. citizens living abroad are up 39 percent since FY 2013. International taxpayers face difficulty in corresponding by phone or mail due to inadequate levels of service and barriers such as tolls and time zone differences. The IRS's plans for expanding self-service options cannot fully replace personal service options. The IRS is limiting the opportunity for interaction and will no longer be able to learn firsthand what taxpayers need. Without a two-way dialogue, information will be filtered and the IRS will decide what it thinks taxpayers need to hear, instead of hearing what information taxpayers want and need.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS reopen the four international tax attaché offices and provide funding for TAS to establish one local taxpayer advocate position at each office; conduct impact studies to determine the effects on taxpayer service, compliance, and revenue by opening additional tax attaché offices around the world; reestablish the ETLA with timeframes for responses and create a process for using the information from ETLA inquiries in updates to IRS internal and external materials, including irs.gov; allocate funding for staffing additional telephone service to accommodate the need created by the expansion of international enforcement activities; create a task force to analyze and provide a report within one year on the barriers to Voice over Internet Protocol (VOIP) usage and partnering with the U.S. Department of State to employ Virtual Service Delivery (VSD) technology for taxpayers at U.S. embassies and consulates; and reinstate the International Individual Taxpayer Assistance Team, with a formal charter, regular meetings, objectives, and measurable results.

## PROBLEMS THAT UNDERMINE TAXPAYER RIGHTS AND IMPOSE TAXPAYER BURDEN

### MSP #8 **APPEALS: The Appeals Judicial Approach and Culture Project Is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers**

#### Problem

Appeals recently implemented the Appeals Judicial Approach and Culture (AJAC) project in hopes of enhancing “internal and external customer perceptions of a fair, impartial and independent Office of Appeals.” Although AJAC’s aspirations are commendable, its practical implementation is eroding the very perceptions of fairness and objectivity that it claims to bolster. For example, non-docketed Appeals cases have fallen by 25 percent between fiscal year end (FYE) 2011 and FYE 2015, a decline that AJAC has only perpetuated. Further, AJAC is being used as a justification by Compliance to intimidate taxpayers and deny their right to an administrative appeal. If taxpayers are able to get to Appeals, they are subjected to an AJAC regime that is causing cases to bounce back and forth between Appeals and Compliance and resulting in curtailed review by Hearing Officers of the cases they retain.

#### Analysis

Under the guise of AJAC, Compliance has adopted a more stringent policy that closes cases and bypasses Appeals unless a taxpayer provides all requested documentation or certifies that no additional information is available. At the urging of TAS, Compliance agreed to temporarily discontinue this approach (which had been pursued through the Letter 5262 series), but is now considering reinstating it, with some minor modifications. Further, cases in Appeals face the increased risk of being unnecessarily shuttled between Compliance and Appeals, and TAS is concerned that a robust consideration of the taxpayer’s case is all too often lost in the rush to judgment. Several practitioners have reported that, under AJAC, Appeals Hearing Officers (Hearing Officers) are in greater haste and that a more adversarial environment has been created.

#### Recommendations

The National Taxpayer Advocate recommends the IRS permanently discontinue the Letter 5262 series and preserve taxpayer’s rights to an appeal, even in cases where all requested information is not provided to Compliance; loosen AJAC restrictions to allow Hearing Officers to exercise more discretion regarding whether additional factual review and analysis by Compliance would materially assist case resolution; provide Hearing Officers with revised guidance and enhanced training emphasizing quality substantive review, rather than mere satisfaction of procedural requirements by expanding timeframes and retaining Appeals’ jurisdiction where appropriate, as the best means of providing taxpayers with the *right to appeal an IRS decision in an independent forum*; and develop and implement an outreach plan aimed at practitioners to help them understand what is needed for a successful appeal and to provide Appeals with information about the difficulties experienced by taxpayers and practitioners under AJAC.

## **MSP #9      COLLECTION APPEALS PROGRAM (CAP): The CAP Provides Inadequate Review and Insufficient Protections for Taxpayers Facing Collection Actions**

### **Problem**

The IRS developed the Collection Appeals Program (CAP) as a response to congressional concerns regarding the rights of taxpayers subject to collection activity relating to liens, levies, and installment agreements. CAP hearings provide taxpayers with some distinct benefits in comparison to Collection Due Process (CDP) Appeals, including expedited timeframes and the ability to challenge determinations regarding installment agreements. They remain severely limited, however, in the remedies and scope of review they offer taxpayers. CAP rejects substantive review and a consideration of collection alternatives, which would involve a balancing of the proposed collection action versus the taxpayer's legitimate concern regarding intrusiveness of the collection action, in the name of speed, a circumstance that has only been made worse by procedures implemented under the Appeals Judicial Approach and Culture (AJAC) project. Further, pursuit of a CAP hearing by a taxpayer can inadvertently cause the loss of all substantive administrative and judicial review of a collection action.

### **Analysis**

CAP provides only limited protections to taxpayers and, likely as a result, has been underutilized in comparison with CDP appeals, which allow for a much broader range of review. From fiscal year (FY) 2012 through FY 2015, the IRS has received approximately 44,500 CDP appeals per year, while taxpayers have sought just 4,600 CAP hearings per year over this same period. Only approximately 22 percent of taxpayers fully or partially prevailed in CAP hearings during these years, while 68 percent of taxpayers obtained full or partial relief in CDP appeals. Likely as a result of the limited review and remedies provided by the CAP process, taxpayers seldom prevail in, and infrequently utilize, CAP hearings.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS revise the policies and procedures governing CAP to allow Hearing Officers the expanded authority, and where necessary, the additional time, to review Collection alternatives and remand cases to Collection for consideration of those alternatives; issue guidance specifying that taxpayers' use of CAP will no longer preclude them from receiving an independent reconsideration via a CDP appeal based on either issue preclusion or *pro forma* adoption of the prior CAP decision; and after implementing these improvements in CAP, make a concerted effort to publicize the benefits of CAP and ensure that Hearing Officers, and all IRS employees with taxpayer contact, more effectively inform taxpayers and their representatives about the availability of CAP hearings.

## **MSP #10 LEVIES ON ASSETS IN RETIREMENT ACCOUNTS: Current IRS Guidance Regarding Levies on Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts With Retirement Security Public Policy**

### **Problem**

Taxpayers rely on retirement accounts to fund living and other expenses after retirement. Congress for years has encouraged retirement savings and formulated policies to protect these rights. Current Internal Revenue Manual (IRM) guidance lacks a definition for flagrant conduct (a prerequisite for the levy) and contains inadequate instruction for analyzing future retirement calculations. The IRS guidance that explains the steps required before a retirement account can be levied contains inadequate detail, and is insufficient to protect taxpayer rights or enable taxpayers to meet basic living expenses in retirement.

### **Analysis**

The current IRM guidance is not only vague but it is overbroad, and as a result there is too much subjectivity involved in the decision to levy a retirement account. Moreover, the IRS does not track retirement account levies and therefore is unable to conduct quality reviews. TAS reviewed 43 possible Thrift Savings Plan (TSP) levy cases and found that in 33 cases, the notice of levy was issued. In 31 of those cases, the IRS employee did not document required managerial approval. Flagrant conduct, a prerequisite for the levy, was only recorded in one case. The IRS has proposed a TSP levy pilot within its Automated Collection System (ACS) unit, which could automate much of the decision to levy on a TSP retirement account, and would result in disparate treatment of TSP accounts compared to other retirement accounts.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS, in collaboration with TAS, revise the IRM on retirement account levies to define flagrant conduct as conduct that is willful and voluntary as well as conduct that a reasonable person would view as a gross violation, include examples of extenuating circumstances, and include a full financial analysis; identify calculators to determine the impact of a levy on the taxpayer's future wellbeing, or alternatively, create its own calculator; create a unique identifier to track and review retirement levy cases; and postpone the ACS retirement levy pilot program until all of the National Taxpayer Advocate's concerns have been addressed, and if they are not able to be addressed, do not implement the pilot.

## **MSP #11 NOTICES OF FEDERAL TAX LIEN (NFTL): The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer's Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection**

### **Problem**

Notices of Federal Tax Lien (NFTLs) establish priority of the government's interest in a tax debtor's property by putting the public, including third party creditors, on notice of an existing lien. Several TAS studies show that NFTLs can unnecessarily harm taxpayers and reduce their ability to become or remain compliant with their federal tax filing obligations. NFTLs also generate significant downstream costs for the government, often without attaching to any tangible assets. The IRS files most NFTLs based on an arbitrary dollar threshold of the unpaid liability, with over 21 percent of liens filed without human involvement in determining lien filing, rather than conducting a thorough analysis of the taxpayer's individual circumstances and financial situation, or consideration of the NFTL's impact on future compliance and collected revenue. Current IRS lien policies can have a negative impact on taxpayers' economic viability, ability to pay the past debt, and comply in the future.

### **Analysis**

The current NFTL filing policy is based on an arbitrary dollar threshold of the unpaid liability, rather than focused on meaningful contact with the taxpayer. The IRS generally files NFTLs if the aggregate unpaid balance of assessment is over \$10,000, or for accounts in the Automated Collection System (ACS), if the assessment is over \$25,000. Under current procedures, the request for an NFTL filing, or appropriate non-filing documentation, must be prepared within ten calendar days of the initial attempted contact or initial actual contact with the taxpayer. A contact is made by either a field contact by a Revenue Officer, a telephone call, or mailing a notice to the taxpayer's last known address. However, a majority of attempted telephone calls by ACS using predictive dialers do not result in actual contact with the taxpayers. Even when the taxpayer attempts to initiate contact with the IRS by calling the number provided on the majority of notices, only about one in three taxpayers can get through to the IRS to make payment arrangements prior to NFTL filing.

The IRS is "one of the largest financial institutions in the world," but has not implemented financial analysis techniques and certain automation techniques used by modern financial institutions, including financial scoring, credit risk analysis, and modeling. A recent TAS research study, which can be found in Volume 2 of this report, reveals that early interventions drive the collection of revenue. The IRS has agreed to conduct a lien pilot study to determine whether lowering the ACS NFTL filing threshold from \$25,000 to \$10,000 would result in enhanced protection of the government's interest and would facilitate the collection of delinquent tax liabilities, without unnecessarily harming the taxpayer. The pilot is slated to begin in February 2016.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS revise the IRM to require employees to make multiple attempts to initiate a meaningful personal contact with the taxpayer by phone or through mailing notices, instead of filing a NFTL after just one attempt; adopt an early intervention policy similar to the new standard in the mortgage industry that requires two contacts, one of which is a person-to-person attempt, rather than simply mailing a letter; increase the ten-day time frame for filing a lien to enable taxpayers to reach out to the IRS and provide financial information; continue to mail monthly notices to the taxpayer while the account is in the queue, ACS, or field; in collaboration with TAS, develop criteria

for conducting the lien pilots as agreed upon with the National Taxpayer Advocate, and refrain from decreasing the NFTL filing thresholds until the results from the lien pilots can be examined and discussed; amend the IRM and related e-Guides and training materials to incorporate rules for NFTL filing determinations, including meaningful contact, analysis of the taxpayer's financial situation, and the impact on future compliance; incorporate credit scoring and automated asset verification into the financial analysis for making NFTL filing determinations in ACS, with the provision to elevate close call and complex cases to a manager; and update the e-Guides with a series of questions determining if the taxpayer has or is likely to have assets to which an NFTL can actually attach.

## **MSP #12 THIRD PARTY CONTACTS: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations**

### **Problem**

The IRS does not empower taxpayers to provide information that would make third party contacts (TPC) unnecessary. Nor does it periodically inform them about the TPCs it made, as required by statute, so that they can mitigate damage to their reputations.

### **Analysis**

The IRS is generally required by Internal Revenue Code § 7602(c) to give the taxpayer advanced notice of a TPC, and reports of any TPCs both periodically and upon request. Advance notice is supposed to empower the taxpayer to volunteer information that would make the TPC unnecessary, avoiding damage to his or her reputation or business. However, the IRS's TPC notices generally do not identify the information the IRS needs, inform the taxpayer the IRS *will* make a TPC in his or her case, or give the taxpayer with enough time to provide the information. A TAS review found the IRS did not even ask taxpayers for the information before making the TPC in 22.8 percent of field exam cases and in 11.1 percent of field collection cases. In addition, the IRS does not provide periodic post-contact reports, and taxpayers have no reason to request them if they do not know the IRS has made a TPC. A TAS review of IRS cases did not identify any where a taxpayer requested one. Moreover, these reports are likely to be incomplete. TAS's review found in 48.5 percent of field collection cases and 42.1 percent of field exam cases with TPCs, the IRS made TPCs not reflected in the database used to generate these reports. The IRS's failure to follow the statutory scheme impairs five of the ten taxpayer rights, including the *rights to be informed, to a fair and just tax system, to privacy, to confidentiality, and to challenge the IRS's position and be heard.*

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS should generally include with a TPC notice a request for information that would make the TPC unnecessary and copy the taxpayer on most written requests for information it sends to third parties; should provide taxpayers with post-TPC reports periodically and with more specific direction about how to request them; and should strengthen internal controls to ensure these reports are accurate.

## **MSP #13 WHISTLEBLOWER PROGRAM: The IRS Whistleblower Program Does Not Meet Whistleblowers' Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers' Confidential Information From Re-Disclosure by Whistleblowers**

### **Problem**

In 2006, in the light of empirical evidence that audits initiated on the basis of whistleblower information are an efficient means of recovering unpaid tax liabilities, Congress added subsection (b) to Internal Revenue Code (IRC) § 7623. The new provision requires the IRS to award certain whistleblowers an amount between 15 and 30 percent of the collected proceeds, created the IRS Whistleblower Office, and provides for Tax Court review of whistleblower award determinations. The legitimate purpose of enforcing tax compliance, when accomplished by using whistleblowers, creates risks for the subject of the whistleblower claim, especially when the claim is unsupported or not pursued. Voluntary compliance may be undermined if taxpayers perceive the IRS is not adequately guarding their tax information. The whistleblower program as currently administered by the IRS and existing IRC provisions do not adequately balance these concerns.

### **Analysis**

It takes the IRS almost five years on average to make payouts of IRC § 7623(b) claims. The IRS has never availed itself of IRC § 6103(n), an exception to the statutory prohibition on disclosing confidential taxpayer information, that would allow it to update whistleblowers on the status of their claims and protect taxpayer confidential information from re-disclosure by the whistleblower. The IRS does rely on other exceptions to the statutory prohibition on disclosure, IRC § 6103(k)(6) and (h)(4), which do not adequately protect taxpayers from re-disclosure of their confidential information by whistleblowers.

### **Recommendations**

The IRS and Treasury should revise the regulations under IRC § 7623 to provide that a whistleblower “administrative proceeding” within the meaning of IRC § 6103(h)(4) commences with the whistleblower’s submission of the claim for award. The regulations under IRC § 6103 or IRC § 7623 should also be revised to provide that the IRC §§ 7431, 7213, and 7213A penalties apply to re-disclosures of returns or return information by a whistleblower who has executed a confidentiality agreement as part of an IRC § 6103(h)(4) administrative hearing, and that the IRC § 6103(p) safeguarding requirements also apply to such a whistleblower. The IRS and Treasury should also revise the regulations under IRC § 7623 to require the IRS, upon the whistleblower’s execution of a confidentiality agreement as part of an administrative hearing under IRC § 6103(h)(4), to provide bi-annual status updates that allow the whistleblower to monitor the status of the claim according to procedures developed by the Whistleblower Office.

## **MSP #14 AFFORDABLE CARE ACT (ACA) – BUSINESS: The IRS Faces Challenges in Implementing the Employer Provisions of the ACA While Protecting Taxpayer Rights and Minimizing Burden**

### **Problem**

The IRS is charged with implementing complex Affordable Care Act (ACA) provisions that require updating information technology systems, issuing guidance, and collaborating with other federal agencies. For tax years 2015 and beyond, certain provisions of the ACA impacting employers become effective. For example, applicable large employers (ALEs) must offer minimum essential coverage (MEC) to their full-time employees. Employers not in compliance with these provisions may be subject to an assessable payment, referred to as the “employer shared responsibility payment” (ESRP). The National Taxpayer Advocate is concerned that the IRS’s implementation of the ACA provisions for the 2016 filing season may burden both employers and employees if certain conditions and issues are not addressed. For example, employees in the newly-established ACA Business Exam unit need to receive specialized training on the parts of ACA implementation that impact businesses.

### **Analysis**

The IRS has not yet firmed up its approach to selecting and working cases involving ACA business issues, even as the 2016 filing season is rapidly approaching. Once the IRS has determined which group of employees will focus on examining employers’ compliance with the business aspects of the ACA, this new group of employees will require comprehensive and specialized training. The IRS expects to develop procedures and roll out training for these employees before the ESRP cases are assigned, but has not committed to a certain date. The IRS will receive and process an estimated 77 million new information returns from ALEs during the 2016 tax year and use this information to assess ESRP. No information has been provided to TAS regarding the IRS’s plans to test the ability of its Information Technology systems to handle the expected volume of ACA information returns. If the IRS receives incomplete or inaccurate data, taxpayers will be harmed. For example, if the IRS receives inaccurate data regarding coverage, it may erroneously assess ESRP on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS provide additional guidance on how to calculate the number of full-time equivalent employees for purposes of meeting the MEC requirements; publish regulations explaining how the IRC § 4980D excise tax may apply to certain flexible spending accounts and health reimbursement arrangements; establish a Rapid Response team to assist with issues, problems, or questions from employers or tax practitioners; and provide employees in its newly-established ACA Business Exam unit with comprehensive and specialized training on concepts such as ALE, MEC, and ESRP.

## **MSP #15 AFFORDABLE CARE ACT – INDIVIDUALS: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions**

### **Problem**

Overall, the IRS has done a commendable job of implementing the first stages of the Patient Protection and Affordable Care Act of 2009 (ACA). The 2015 filing season (FS) presented difficult challenges with the introduction of the Individual Shared Responsibility Payment (ISRP) and the Premium Tax Credit (PTC) on tax year 2014 federal income tax returns. While the IRS performed well overall in FS 2015, several developments will likely result in significant burden imposed on both taxpayers and the IRS in future years. For example, the pre-refund Automated Questionable Credit (AQC) procedures for PTC mismatches are identical to and impose the same burden as post-refund PTC examinations, yet the IRS maintains it can conduct both a pre-refund AQC review and a post-refund audit of another issue, thereby undermining the important statutory protection against multiple audits.

### **Analysis**

The IRS faces several issues related to ACA implementation and enforcement as it heads into FS 2016. First, taxpayers who received the advanced premium tax credit (APTC) in 2014 and did not file TY 2014 returns (and the Form 8962) by Fall 2015 will face difficulties receiving APTC payments in 2016. Second, the pre-refund AQC procedures for PTC mismatches impose the same burden as a post-refund PTC examination without the same due process protections, thereby subverting the statutory protections against multiple audits of the same return. Third, taxpayers who receive certain large lump sum payments after receiving APTC may be caught off guard by having to repay APTC amounts, as well as penalties and interest. Fourth, the absence of the Second Lowest Cost Silver Plan (SLCSP) amounts on some Forms 1095-A are delaying the processing of PTC returns and imposing unnecessary burden on taxpayers. Fifth, the inability of health insurers and self-insured employers to match taxpayer identification numbers (TINs) before filing leads to unnecessary mismatches and notices, increasing issuer burden and wasting IRS resources.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS take preventive measures to avoid ISRP overpayments in the future; issue guidance to field compliance employees to assist them in identifying returns with a tax liability resulting from the correction of Forms 1095 errors in the SLCSP information and not pursuing collection, including blocking the accounts from refund offsets; work with the National Taxpayer Advocate on revising Letters 5591, 5591A, and 5596 for FS 2016 to include the exact date by which the taxpayer needs to file in order to automatically re-enroll for the APTC the following year; conduct outreach and education to inform taxpayers early in FS 2016 about the consequences of filing for an extension if the taxpayer received APTC; determine a method to identify all issues relating to a return, as selected by the various filters in the filing season, and include all of the issues in one notice to the taxpayer so that the taxpayer does not have multiple audits with respect to the same return; conduct outreach and education on the consequences of receiving large lump sum distributions to APTC recipients and organizations making such distributions; issue guidance to both taxpayers and IRS employees about how taxpayers can use the look-up tool on Healthcare.gov to find their SLCSP premium amount; provide a similar IRS tool to ensure IRS employees can look up the SLCSP amount; reform the rules for exchange reporting on Forms 1095-A and require the Marketplace to provide the SLCSP amounts on all such forms; expand the TIN matching program to include health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.

## PROBLEMS THAT WASTE IRS RESOURCES AND IMPOSE TAXPAYER BURDEN

### **MSP #16 IDENTITY THEFT (IDT): The IRS's Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long**

#### **Problem**

In general, tax-related identity theft (IDT) occurs when an individual intentionally uses the personal identifying information of another person to file a falsified tax return with the intention of obtaining an unauthorized refund. As of the end of September 2015, the IRS had over 600,000 IDT cases with taxpayer impact (excluding duplicates) in its inventory, up nearly 150 percent from September 2014. In July 2015, the IRS reorganized its IDT victim assistance functions, centralizing them under one umbrella within the Wage and Investment division. While the National Taxpayer Advocate is pleased the IRS has finally adopted this approach, she continues to have concerns about the IRS's IDT victim assistance procedures. For example, the IRS still does not assign a sole IRS contact person to interact with IDT victims with multiple tax issues, it does not track IDT cycle time in a way that accurately represents the taxpayer's experience, and it continues to limit the availability of Identity Protection Personal Identification Numbers (IP PINs) to a small segment of the population.

#### **Analysis**

The inadequacy of the IRS's IDT victim assistance is demonstrated by the growth in TAS IDT cases, which comprised 25 percent of TAS's case receipts for fiscal year 2015. A significant portion of these cases is attributable to false positives from IRS screening mechanisms; in one program, approximately one out of three returns suspended by the IRS were legitimate returns. In September 2015, the IRS convened the IDT Re-engineering Team, a group of employees from across various functions (including TAS) tasked to review current procedures and make recommendations to improve the processing of IDT cases. The Re-engineering Team has already made incremental improvements in IDT victim assistance; however, the IRS has not formally agreed to any of the recommendations listed below. We look forward to working cooperatively with the new Identity Theft Victim Assistance unit to further improve service to this vulnerable population of taxpayers.

#### **Recommendations**

The National Taxpayer Advocate recommends for identity theft victims with multiple issues that the IRS assign a sole contact person (and provide a toll-free direct extension to this contact person) to interact with the IDT victim and oversee the resolution of the case; track IDT cycle time in a way that reflects the taxpayer's experience more accurately; revamp its global account review procedures to ensure all related issues are actually resolved (including issuance of a refund, if applicable) prior to case closure, and conduct appropriate training for its employees; and expand its IP PIN pilot to allow taxpayers in every state the ability to opt in.

## **MSP #17 AUTOMATED SUBSTITUTE FOR RETURN (ASFR) PROGRAM: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden**

### **Problem**

When a taxpayer who has a filing requirement fails to file a tax return, the IRS is authorized under Internal Revenue Code § 6020(b) to use third-party information, such as Forms W-2 and 1099, to determine and assess a tax liability. This is principally worked through the Automated Substitute for Return (ASFR) program, the IRS's key program for enforcing filing compliance on taxpayers who have not filed individual income tax returns but appear to owe a tax liability. If a taxpayer has not filed a return and the IRS determines that a taxpayer has a filing requirement, it will typically select the case to prepare a substitute for return and assess the liability based on the third-party information, but it does not allow any itemized deductions or credits that might be supported by third-party information, and only allows a filing status of single or married filing separately. The ASFR program has poor collection results and a high abatement rate, which shows that ASFR's selection criteria are inefficient and lead to inflated liabilities that are later abated.

### **Analysis**

In fiscal years (FYs) 2011 through 2014, the IRS assessed nearly \$34 billion through its ASFR authority. The IRS collected nearly one-third of this amount, about \$11 billion. In FYs 2011 through 2014, the IRS abated nearly \$10 billion of the ASFR assessments, for a total of 29 percent of all ASFR assessments. Further, the ASFR program's return on investment is small. In FY 2014, prior to the initial balance due notice, the ASFR program had revenue of \$89.5 million, but spent \$39.8 million operating the ASFR program, which does not include the costs of later abating liabilities, or the expense of sending out notices or making collection attempts. This means the IRS generated net revenue of about \$50 million when accounting for the cost of the program. This poor performance can be attributed, at least in part, to the ASFR program's inflated liabilities which are created by not considering third-party information that would support deductions and credits. Not only does this lead to the program's poor performance, but it also wastes IRS resources by having to later abate the liability, and unnecessarily subjects taxpayers to collection action.

### **Recommendations**

The National Taxpayer Advocate recommends that Congress review annually where ASFR assessments have had the most success in getting taxpayers to file an original return and adjust the ASFR selection process to focus on similar types of cases; refine ASFR abatement reason codes, making them more specific, so the IRS can use this information when determining if a case should be selected for the ASFR program; and when selecting cases for ASFR, consider third-party documentation that supports exemptions, deductions, and credits before making ASFR assessments.

## **MSP #18 INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): IRS Processes Create Barriers to Filing and Paying for Taxpayers Who Cannot Obtain Social Security Numbers**

### **Problem**

Problems obtaining Individual Taxpayer Identification Numbers (ITINs) have long plagued taxpayers who have a tax return filing requirement, but are ineligible for a Social Security number (SSN). When taxpayers cannot obtain ITINs timely, or at all, they may face financial hardship and limitations on where and with whom they can do business. Some taxpayers may drop out of the tax system altogether. ITIN applications and associated returns filings have dropped precipitously in recent years. While the general economic climate and immigration trends help explain this decline, IRS procedures have most certainly contributed to it. Concerns about ITIN refund fraud are legitimate; the IRS's solutions, however, do not effectively target the fraud nor do they balance the anti-fraud regime with the taxpayer's need for a process no more intrusive than necessary, part of a taxpayer's *right to privacy*. As a result, the IRS burdens legitimate taxpayers and harms global commerce.

### **Analysis**

ITINs play a vital role in the U.S. tax system. Without ITINs, approximately 4.6 million taxpayers would not be able to comply with their annual tax filing and payment obligations, or receive tax benefits to which they are legally entitled. The requirement to apply for an ITIN during the filing season burdens applicants, creates delays, leads to lost returns, and hampers the IRS's ability to detect and prevent fraud. During the 2015 filing season, the IRS advised taxpayers to wait up to 11 weeks for their ITIN applications to be processed and at one point had a backlog of nearly 120,000 ITIN applications with returns. The requirement for applicants to submit original documentation with only limited alternatives significantly burdens applicants, leads to lost documents, results in delays in returning documents to taxpayers, and creates additional work for a resource-constrained IRS. Combined, these requirements contribute to errors on the parts of the ITIN unit and applicants, resulting in growing suspension and rejection rates. In addition, ITIN applications and associated return filings have dropped precipitously, down 58 percent between 2011 and 2014. Finally, the IRS's future plans for deactivating ITINs will deprive some taxpayers of ITINs they need for tax administration purposes and undermine their *right to be informed*.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS allow all ITIN applicants to apply for an ITIN at any time of the year without submitting a tax return as long as they provide other evidence of a legitimate tax administration purpose for the ITIN; accept documentation such as pay stubs or bank statements as evidence of a filing requirement and thus evidence of a legitimate tax administration purpose for an ITIN; process all tax returns which meet the Beard test for a valid return, notify taxpayers if their returns will not be processed, and provide administrative appeal rights if claims for refund are not allowed; allow Certifying Acceptance Agents (CAAs) to certify documents for dependent applicants; in consultation with the National Taxpayer Advocate, create guidelines for determining whether a taxpayer will face a hardship if identification documents are not returned by expedited mail and send documents by expedited mail where such a determination is made; allow Taxpayer Assistance Centers (TACs) to certify all types of identification documentation for ITIN applications; partner with the Department of State to provide certification of ITIN applications at U.S. embassies and consulates abroad; clarify the deactivation policy to state the IRS will deactivate an ITIN that has not been used on at least one tax return, which includes both individual returns and information returns filed by third parties, in the past five years; and notify all taxpayers at their last known address at least three months prior to the deactivation of their ITINs while providing guidance for how to reactivate the ITIN or challenge a deactivation the taxpayer believes is in error.

## **MSP #19 PRACTITIONER SERVICES: Reductions in the Practitioner Priority Service Phone Line Staffing and Other Services Burden Practitioners and the IRS**

### **Problem**

The Practitioner Priority Service (PPS) was designed to be the first point of contact with the IRS for practitioners. Practitioners with questions have a designated professional support line they can call to receive guidance and answers regarding their clients' account related issues. The IRS reduced the scope of provided services and eliminated necessary staffing to the PPS. As a result, practitioners calling the PPS line spend more time on hold, have a lower chance of getting through to a live customer service representative, and use the PPS for fewer services than in previous years.

### **Analysis**

The *right to retain representation* is negatively affected when practitioners cannot reach the IRS in a reasonable amount of time and are unable to resolve issues involving their clients' accounts. Since 2011, staffing levels for the PPS have dropped by about 30 percent and wait times have increased to an average of over 45 minutes during fiscal year (FY) 2015. The number of attempted practitioner calls increased in FY 2015 and the percentage of answered calls decreased by more than 30 percent. During FY 2014, the customer service representative level of service (LOS) was about 70 percent; this number dropped to less than 48 percent for FY 2015. In addition to the long wait times, practitioners are confronted with a limited scope of services being provided by the PPS and an inability to get answers to complex tax law questions regarding their clients' accounts. The erosion of services to the PPS and increased wait times places practitioners and their clients at greater risk for negative tax consequences.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS restore staffing levels to the PPS, allow the resolution of complex tax law issues by allowing practitioners to ask necessary questions, allow practitioners to resolve as many as five separate client account issues during one call as stated in the Internal Revenue Manual (IRM), consult with the practitioner community for suggestions on most needed changes to the PPS, and continue to retain the PPS as an avenue for resolution of tax issues alongside any online channels that may be created.

## **MSP #20 IRS COLLECTION EFFECTIVENESS: The IRS's Failure to Accurately Input Designated Payment Codes for All Payments Compromises Its Ability to Evaluate Which Actions Are Most Effective in Generating Payments**

### **Problem**

IRS guidance instructs employees to designate every payment it receives from a taxpayer with a specific code. Employees are directed to input a two-digit Designated Payment Code (DPC) to help identify payments, indicate application of the payment to a specific liability, and identify the event that primarily precipitated the payment (*e.g.*, liens, levies, offers in compromise, and installment agreements). The input of DPCs provides a way to track taxpayer behavior and future compliance. However, the IRS is not consistently or accurately applying DPCs, which reduces the IRS's ability to assess the effectiveness of its collection actions. Such failure prevents the IRS from measuring what actions, including processes such as the notice stream and the filing of a Notice of Federal Tax Lien (NFTL), were most successful in getting the taxpayer to pay on a balance due account. As a consequence, the IRS is blindly applying its broad collection powers and resources rather than analyzing accurate information to determine funding priorities (*i.e.*, what actions — sending a letter, making a phone call, or taking collection action — would yield the best return on investment). As a result, IRS actions are likely to be more intrusive than necessary, harming taxpayers and undermining voluntary compliance.

### **Analysis**

In calendar year 2014, 87 percent of payments either had no DPC or defaulted to DPCs of “00” (undesignated payment) or “99” (miscellaneous). A 2012 Treasury Inspector General for Tax Administration report raised similar concerns. Specifically, the report showed that 77 percent of payments reviewed were processed without the required DPC, including payments received after an NFTL was filed. Additionally, 34 percent of payments that did have a DPC placed on the payment had an incorrect DPC. A recent IRS study also found that certain DPCs were too vague to be helpful, that IRS DPC guidance is inconsistent, and an absence of systemic review of DPCs impedes the IRS's ability to obtain useful information. The study recommended several common sense improvements, which IRS Collection officials rejected as too costly. In other words, the IRS determined it was better to continue to operate under a collection strategy conceived in a vacuum instead of adopting an approach that increases collection effectiveness and minimizes harm to the taxpayer.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS revise IRM guidance and guidelines for lockbox receipts to require the entry of specific DPCs on all balance due payments; require Submission Processing employees to verify the presence of an appropriate DPC on payments by conducting regular quality reviews; provide clear and specific guidance about the circumstances under which employees can use a miscellaneous DPC; and implement systemic input of most payment codes.

## **MSP #21 EXEMPT ORGANIZATIONS (EOs): The IRS's Delay in Updating Publicly Available Lists of EOs Harms Reinstated Organizations and Misleads Taxpayers**

### **Problem**

The IRS maintains a list of tax exempt organizations (EOs) on two publicly accessible online databases, the Exempt Organizations Business Master File (EO BMF) and Exempt Organizations Select Check (EO Select Check). When an EO fails to file an information return or notice for three consecutive years, its exempt status is automatically revoked, the IRS removes the EO from its online-published lists of EOs and places it on a list of automatically revoked organizations. Unless the automatic revocation was due to IRS error, an automatically revoked organization must submit a new application to have its exempt status reinstated. Even if the IRS promptly reinstates the organization or discovers its error, IRS databases will not immediately reflect the organization's restored exempt status because the IRS only updates its databases monthly, except in January when the databases are not updated at all. Therefore, reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status, which may be an existential issue for some organizations.

### **Analysis**

The IRS recognizes the reliance on the EO BMF and EO Select Check databases by individual donors, who use them to verify that their contributions will be tax deductible, and private foundations, which use them to verify that they are making a grant to a qualifying public charity. However, the IRS does not update these databases in a timely manner, causing reinstated automatically revoked organizations to potentially lose out on donations or grants. In addition, these databases are not updated at all from the second Monday in December until the second Monday in February, a period that includes the critical year-end fundraising push. The number of automatic revocation reinstatement cases during this gap period exceeded 2,500 in both fiscal years 2014 and 2015, and more than 70 percent of these cases were 501(c)(3) organizations. A determination letter from the IRS or a phone call to the IRS (where callers are subject to lengthy hold times) may not satisfy a potential donor or grantor. Many donors or grantors may simply "move on" and make a donation or grant to an organization that appears on EO Select Check and EO BMF.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS update EO BMF and Select Check on a weekly basis as is the case for Form 990-N updates; until appropriate programming changes can be made, update EO Select Check manually; and implement an emergency process that, even when there is weekly updating, allows for manual database updates within 24 hours of the restoration of exempt status.

## PROBLEMS THAT CONTRIBUTE TO EARNED INCOME TAX CREDIT NONCOMPLIANCE AND RECOMMENDATIONS FOR IMPROVEMENT

### **MSP #22 EARNED INCOME TAX CREDIT (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-Filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-Filing Questions From Low Income Taxpayers About Their EITC Eligibility**

#### **Problem**

The Earned Income Tax Credit (EITC) population often shares a unique set of attributes that create obstacles for EITC compliance, such as low levels of education and high transiency. Additionally, one third of the eligible population changes every year. Under these circumstances, it is difficult for taxpayers to understand EITC eligibility rules. During the filing season, the IRS provides toll-free assistance for answering basic tax law questions from any taxpayer, and only rudimentary help for taxpayers with EITC questions. By failing to provide EITC taxpayers with a dedicated toll-free helpline staffed by assistors with whom they can check their EITC eligibility, the IRS disregards the specific and unique needs of the EITC population and perpetuates high noncompliance rates.

#### **Analysis**

TAS research shows that taxpayers claiming the EITC need additional assistance in order to understand EITC eligibility and avoid noncompliance. In one TAS study, 26.5 percent of surveyed taxpayers did not know from reading the EITC audit letter that they were being audited. Another TAS study determined that over 75 percent of low income respondents preferred in-person meetings and meetings at a community service center compared to 28 percent who preferred telephone contact and 13 percent who preferred contact by writing. In the United Kingdom (UK), Her Majesty's Revenue and Customs (HMRC) provides a dedicated helpline for tax credit inquiries. This helpline provides advice on tax credits, allows taxpayers to report changes in their circumstances, and provides a venue for taxpayers to make complaints. HMRC's study of taxpayers' experiences, perceptions, and attitudes showed that a majority of taxpayers in the UK preferred using this dedicated helpline for their source of information over all other services provided by HMRC. Taking a similar approach could help the IRS pinpoint where mistakes are likely to occur in EITC claims, increase efficient use of resources, and encourage taxpayers' participation in EITC compliance. A dedicated helpline would address low income taxpayers' needs by accommodating their mobility *before* filing their tax returns and help avoid future noncompliance.

#### **Recommendations**

The National Taxpayer Advocates recommends that the IRS conduct a study similar to the UK experiment to determine how best to serve low income taxpayers and based on the findings from the proposed study, and create a helpline dedicated to EITC eligible taxpayers who can call and ask questions about their particular area of concern.

## **MSP #23 EARNED INCOME TAX CREDIT (EITC): The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance**

### **Problem**

The law surrounding the Earned Income Tax Credit (EITC) is complex. In addition, one third of the eligible EITC population changes every year. At the same time, the population of taxpayers who rely on the EITC often share a common set of characteristics, such as low education and high transiency, which create challenges for taxpayer compliance. Notwithstanding these challenges, the IRS persists in using traditional audits as its primary compliance tool.

### **Analysis**

The EITC audit program has a no-response rate of over 40 percent, raising questions about the accuracy of some default assessments and of the audit's effectiveness as an educational tool for future compliance. The IRS also may not be auditing the group of EITC returns that have the most noncompliance. TAS' analysis of the National Research Program (NRP) EITC audits shows that in tax year 2008, approximately 86 percent of the NRP audited cases did not trip a Dependency Database (DDB) rule. NRP data also show that approximately 75 percent of children claimed in error fail the residency test and only 20 percent fail the relationship test. However, about 70 percent of the DDB audits for tax year (TY) 2012, failed both the residency and relationship DDB audit rules. This data suggests that the IRS is concentrating its EITC audit resources on taxpayers with a noncompliance issue that is relatively minor.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS conduct an EITC pilot with three different treatments; assign one employee to each EITC audit in correspondence examination; use National Research Program data to design a formula for workload selection, in addition to the Dependent Database; revise the IRM to include the list of additional documentation, as listed in the TAS IGM, as well as to accept alternative documentation; and collaborate with TAS, so that the IRM guidance requires correspondence examiners to adjust accounts for the childless worker credit.

## **MSP #24 EARNED INCOME TAX CREDIT (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance**

### **Problem**

Fifty-five percent of returns claiming EITC were prepared by paid return preparers in tax year 2013. Despite the involvement of so many paid preparers, the EITC suffers from a high noncompliance rate. In response, the IRS has created an EITC Return Preparer Strategy, which incorporates multiple approaches to improve the compliance behavior of EITC return preparers. However, the strategy overlooks opportunities to reach unscrupulous return preparers, which limits the program's effectiveness. Moreover, the IRS does not effectively educate taxpayers so they are equipped to identify and avoid incompetent or unscrupulous return preparers. Finally, without an accurate measure of success for each preparer treatment, the IRS cannot determine if the strategy is taking the most effective approach to increase preparer compliance.

### **Analysis**

The EITC Preparer Strategy has various tools at its disposal for addressing noncompliant preparers, referred to as "treatments." However, the current measurement for success of each treatment does not monitor the long-term improvement of a core group of preparers and overlooks preparers who operate outside of the strategy's criteria. Without a true year-to-year analysis, the strategy may be relying on more burdensome treatments than are necessary. Additionally, the strategy does not include a target outreach program specifically designed to address unscrupulous preparers. The preparer compliance strategy should couple its efforts to treat preparers with a marketing campaign to educate taxpayers about the risks of selecting an incompetent or unscrupulous preparer and how to avoid doing so.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS release the annual analysis for the EITC Preparer Strategy to the public; include TAS as a member of the strategy; in collaboration with TAS and other IRS functions, determine where to focus resources and how to measure success; incorporate preparer referrals as a selection criterion; use measures for evaluating the effectiveness of the strategy that include a year-to-year analysis of the preparer's behavior following treatment; tailor outreach to the unenrolled preparer population; conduct a public education campaign for EITC taxpayers about how to avoid incompetent and unscrupulous preparers; and focus that campaign in geographic areas where noncompliant preparers are concentrated.

## LEGISLATIVE RECOMMENDATIONS

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Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress considers a taxpayer perspective.

## RECOMMENDATIONS TO PROTECT TAXPAYER RIGHTS AND REDUCE TAXPAYER BURDEN

### LR #1 STATUTE OF LIMITATIONS: Repeal or Fix Statute Suspension Under IRC § 7811(d)

#### Problem

Under Internal Revenue Code (IRC) § 7811(d)(1) the statutory period of limitations on assessment or collection is suspended “beginning on the date of the taxpayer’s application... [for a Taxpayer Assistance Order (TAO)] and ending on the date of the National Taxpayer Advocate’s decision with respect to such application.” Thus, if the IRS significantly harms a taxpayer and repeatedly ignores his or her concerns, and the taxpayer asks TAS for help, IRC § 7811(d) rewards the IRS for such behavior and punishes the taxpayer by granting the IRS with more time for enforcement. In this way, it undermines TAS’s mission and the taxpayer rights. The IRS has not implemented this law because it is unnecessary and impossible to administer (*e.g.*, because TAS does not track cases that do not meet its acceptance criteria). Without legislation, the IRS will now have to litigate about whether a TAO application also extends deadlines for taxpayers, and if so, for how long. In addition, the law is elective — inapplicable to those who call TAS’s toll-free line — and may penalize uninformed taxpayers who submit written applications. About 54 percent of the taxpayers who requested TAS assistance in writing in FY 2015 were unrepresented — the group most likely to trigger it inadvertently.

#### Analysis

The IRS has not implemented “statute suspension” because its computers cannot track these extensions, and it does not need an extended period of enforcement to protect its interests. It routinely asks the taxpayer to agree to extend these periods and continues enforcement activity, if necessary, even if TAS is involved. A recent decision by the United States Court of Appeals for the Fifth Circuit in *Rothkamm* increases the need for legislation. It held that IRC § 7811(d) extends the period for filing a wrongful levy claim, a deadline applicable to third parties. Thus, anyone who misses a statutory deadline (*e.g.*, the deadline to file a wrongful levy claim, to request a refund or a collection due process hearing, or to petition the tax court) after applying to TAS may now argue that his or her application extended it. This expansion of IRC § 7811(d) and uncertainty about the period to which it applies, will exacerbate implementation problems and increase controversy.

#### Recommendations

The National Taxpayer Advocate recommends that Congress repeal statute suspension under IRC § 7811(d). Alternatively, clarify that it only applies to extend the assessment or collection limitations periods, and only then, when it is likely to make a difference: when expiration of the period is imminent, the taxpayer has declined to extend the period, and a TAO expressly prevents the IRS from pursuing enforcement for more than seven days.

## LR #2     **MATH ERROR AUTHORITY: Authorize the IRS to Summarily Assess Math and “Correctable” Errors Only in Appropriate Circumstances**

### Problem

The IRS has asked Congress to expand its authority (called “math error” authority) to summarily assess tax without following its normal deficiency procedures. These automated procedures, which allow the IRS to bypass certain procedural protections, are limited. If the IRS uses this authority in more complicated and unstudied situations, it will likely adjust more accurate returns, unnecessarily burden taxpayers, erode taxpayer rights, and waste resources.

### Analysis

If the IRS uses summary assessments to address more complex issues, math error notices are likely to become more difficult to understand. Confusing notices may prevent some taxpayers — particularly low income taxpayers — from responding timely. Those who miss the accelerated deadline applicable to math error assessments (60, rather than at least 90 days) lose the opportunity to challenge the adjustment in court before paying. The IRS also wastes resources. It must review additional documentation, process abatement requests and amended returns, and try to respond to calls and letters, and potentially even attempt to collect inaccurate assessments from more taxpayers who are entitled to the benefits they claimed. For example, a TAS study of summary assessments resulting from dependent Taxpayer Identification Numbers (TIN) mismatches found that the IRS subsequently reversed at least part of the assessment in 55 percent of the returns with incorrect TINs. Many were typos. The IRS could have resolved 56 percent of these mismatches using information already in its possession (*e.g.*, the TIN listed on a prior year return). Further, even when the IRS did not reverse the math error because the taxpayer did not respond, the IRS should have reversed it in 41 percent of the cases based on information in its files. Nonetheless, the Administration has repeatedly proposed legislation that would allow the Treasury Department to issue regulations that would apply this process to other “correctable” errors, without specific authorization from Congress.

### Recommendations

The National Taxpayer Advocate recommends that Congress authorize the IRS to summarily assess a deficiency only where (1) there is a discrepancy between the return and reliable data, (2) the IRS can and does explain the discrepancy to the taxpayer clearly, (3) the IRS has evaluated all information in its possession that could help reconcile the discrepancy, (4) IRS employees do not have to evaluate documentation to make a determination, (5) there is a low abatement rate for taxpayers who respond, and (6) for any new criteria or data, the Department of Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported on the reliability of the data or criteria for that purpose.

**LR #3      LEVIES ON RETIREMENT ACCOUNTS: Amend IRC § 6334 to Include a Definition of Flagrancy and Require Consideration of Basic Living Expenses at Retirement Before Levying on Retirement Accounts**

**Problem**

Understanding the importance of Americans having sufficient retirement savings, Congress for years encouraged retirement savings and formulated policies to protect the rights of individuals to pensions. However, the IRS guidance that explains the steps required before a retirement account can be levied contains inadequate detail and is insufficient to protect taxpayer rights. For instance, the determination of whether “flagrant behavior” has occurred is a prerequisite for levying on a retirement account. But there is no on-point definition of what constitutes “flagrant behavior” in the Internal Revenue Code (IRC), accompanying regulations, or the Internal Revenue Manual (IRM). As a result, the determination of flagrancy is left to subjective judgment by individual IRS employees. Furthermore, the IRS is not required to consider the taxpayer’s ability to pay basic living expenses at the time of retirement.

**Analysis**

IRC § 6331 authorizes the IRS to levy on a taxpayer’s property and rights to property, including funds held in retirement accounts. The IRS has established a three-step analysis in the IRM, including determining (1) what property is available to collect the liability; (2) whether the taxpayer’s conduct has been flagrant; and (3) whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses. IRS employees rely on various examples of flagrant conduct, some of which are overly broad and discourage retirement savings for any taxpayer with a tax liability. In addition, the IRS’s financial analysis of necessary living expenses and life expectancy does not include a calculation of a taxpayer’s projected retirement income.

**Recommendations**

The National Taxpayer Advocate recommends that Congress amend IRC § 6334 to define flagrant conduct as willful action (or failure to act) which is voluntarily, consciously, and knowingly committed in violation of any provision of chapters 1, 61, 62, 65, 68, 70, or 75, and which appears to a reasonable person to be a gross violation of any such provision; and to require the IRS to issue regulations describing a full financial analysis of the taxpayer’s projected basic living expenses at retirement prior to allowing a determination to levy on a retirement account.

**LR #4      CHAPTER 3 AND CHAPTER 4 CREDITS AND REFUNDS: Protect Taxpayer Rights by Aligning the Rules Governing Credits and Refunds for Domestic and International Withholding****Problem**

Under Internal Revenue Code (IRC) §§ 1441-1443 (Chapter 3), the IRS imposes withholding on payments made to non-resident aliens and foreign corporations and allows credits and refunds of the amounts to which these taxpayers are entitled. For many years, the operation of this regime closely paralleled the approach taken by the IRS with respect to domestic withholding under IRC § 31. With the advent of the additional reporting and withholding requirements established by the Foreign Account Tax Compliance Act (FATCA), which passed IRC §§ 1471-1474 (Chapter 4), the IRS became increasingly concerned about fraudulent activity on the part of taxpayers and withholding agents. While these fears may have some foundation, the nature and extent of the potential fraudulent activities have not been established by the IRS through any comprehensive studies or statistically significant data. Nevertheless, the IRS has taken the drastic step of freezing Chapter 3 and Chapter 4 refunds for up to one year or longer, while attempting to match the documentation provided by taxpayers with the documentation provided by withholding agents. Further, the IRS has proposed regulations generally providing that taxpayers will be entitled to credits and refunds of withheld amounts only to the extent that their withholding agent properly remits all deposits for all of its taxpayers to the IRS.

**Analysis**

The IRS has treated the implementation of FATCA as an opportunity to alter the assumptions and rules governing Chapter 3 and Chapter 4 withholding. With only minimal explanation and without any comprehensive statistically valid evidence to support its actions, the IRS has shifted from a compliance-based to an enforcement-based model of tax administration in the international withholding context. Taxpayers subject to Chapter 3 and Chapter 4 withholding are assumed to be either intentionally or unwittingly participating in fraudulent conduct and must wait up to one year or longer while the IRS proves the taxpayer's innocence before withheld amounts are released. As of August 31, 2015, over 50,000 such refund claims have been indefinitely frozen. Moreover, the IRS is considering shifting creditor risk with respect to withholding agents, over which taxpayers generally have no control whatsoever, away from the IRS and onto the shoulders of these same taxpayers. This step is particularly unnecessary because approximately 85 percent of these withholding agents are domestic and, therefore, can be reached by the IRS for tax enforcement purposes. The approach taken by the IRS with respect to Chapter 3 and Chapter 4 withholding imperils taxpayers' right to pay no more than the correct amount of tax, right to privacy, and right to a fair and just tax system.

**Recommendation**

To protect taxpayer rights and simplify the tax system, the National Taxpayer Advocate recommends that Congress amend IRC § 33 and IRC § 6401(b)(2) to provide that unless the IRS identifies some affirmative indicia of fraud, taxpayers will be entitled to a full credit or refund if they can demonstrate that withholding occurred at source.

**LR #5 FOREIGN ACCOUNT REPORTING: Eliminate Duplicative Reporting of Certain Foreign Financial Assets and Adopt a Same-Country Exception for Reporting Financial Assets Held in the Country in Which a U.S. Taxpayer Is a Bona Fide Resident**

**Problem**

As a response to IRS and congressional concerns that U.S. taxpayers were not fully disclosing the extent of financial assets held abroad, Congress passed the Foreign Account Tax Compliance Act (FATCA) in 2010. Many U.S. taxpayers, particularly those living abroad, have incurred increased compliance burdens and costs as a result of FATCA reporting obligations on the Form 8938, Statement of Specified Foreign Financial Assets, that significantly overlap with the FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR) filing requirements. The IRS has statutory authority to issue regulations and guidance for the purpose of eliminating duplicative reporting. The IRS has exercised the regulatory authority to eliminate duplicative reporting of assets on the Form 8938 if the asset is reported or reflected on certain other timely-filed international information returns, and provided an exception from reporting financial accounts held in U.S. territories for bona fide residents of such territories. However, it repeatedly declined to adopt the National Taxpayer Advocate's recommendations to forego duplicative FATCA reporting where assets have already been reported on an FBAR, and to allow a same-country exception for reporting financial accounts held in the country in which a U.S. taxpayer is a bona fide resident despite support by other stakeholders. Thereby, the IRS increases taxpayer burdens that include additional tax preparation fees and the unwillingness of some foreign financial institutions (FFIs) to do business with U.S. expatriates because of significant costs and regulatory risks associated with preparing and maintaining a business for ongoing FATCA compliance.

**Analysis**

For several years, the National Taxpayer Advocate and other stakeholders have expressed concerns about the overlap of the FBAR and Form 8938, which increases confusion and adds to the compliance burden for taxpayers. Because FATCA creates burdens for foreign financial institutions, some foreign banks are unwilling to open accounts for U.S. citizens abroad, especially for those individuals residing in small communities where the global banks do not have branches. The National Taxpayer Advocate has personally received multiple reports from taxpayers; taxpayer representatives; tax professionals residing in a range of countries including Austria, Hungary, and Sweden; and from some foreign tax officials themselves.

TAS review of updated and expanded data from fiscal year 2010 through the present continues to demonstrate the weight of FATCA is being felt not by tax evaders, but by U.S. taxpayers who likely would be compliant regardless. U.S. taxpayers under the FATCA umbrella who must file Form 8938 are generally at least as compliant as the overall U.S. taxpayer population — about 1.9 percent Form 8938 filers did not file timely compared to 1.6 percent of the general taxpayer population. In terms of payment compliance, only 2.4 percent of Form 8938 filers did not pay taxes timely compared to 5.9 percent for the general taxpayer population.

As of December 2015, approximately three hundred thousand taxpayers had filed Forms 8938 for Tax Year (TY) 2013, while about 283,000 had filed for TY 2014. Of the taxpayers filing Forms 8938 in TY 2013, approximately 38 percent also filed FBAR forms. Roughly 24 percent of Form 8938 returns were submitted to the IRS from a foreign address based on TY 2012 data.

To mitigate burdens of FATCA compliance for U.S. expatriates and FFIs, the National Taxpayer Advocate submitted recommendations for inclusion in the U.S. Department of Treasury, Office of Tax Policy and

IRS 2014-2015 and 2015-2016 Priority Guidance Plans. Nevertheless, the IRS has not been willing to pursue these recommendations.

### Recommendations

The National Taxpayer Advocate recommends that to reduce the burdens of FATCA compliance Congress amend IRC § 6038D to eliminate duplicative reporting of assets on Form 8938 if the asset is or has been reported or reflected on an FBAR, and to exclude from the specified foreign financial assets required to be reported on the Form 8938, financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a bona fide resident; and amend IRC § 1471 to specifically exclude from the definition of financial account subject to reporting by foreign financial institutions financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a bona fide resident.

## LR #6 INDIAN TRIBAL GOVERNMENTS (ITGs): Treat ITGs As States for Social Security Tax Purposes

### Problem

Indian Tribal Governments (ITGs) have a unique status for federal tax purposes. In 1983, Congress enacted Internal Revenue Code (IRC) § 7871, which provides that ITGs are treated as States for certain tax purposes, acknowledging that, in many respects, ITGs function like States and should therefore be treated as such. More recently, in 2000, Congress decided that ITGs should be treated identically to States with regard to Federal Unemployment Tax Act (FUTA) taxes, allowing ITGs, like State governments, to elect to pay FUTA taxes only when a former employee claims unemployment benefits.

However, ITGs are not treated as States for the purpose of Social Security taxes. Thus, ITG employees who are covered by a State retirement plan are not excepted from Social Security taxes, unlike similarly situated State employees. This inconsistency creates compliance burdens for ITGs and their employees. In addition, as the law currently stands, ITGs may not be able to recruit and retain tribal police officers by offering participation in favorable State pension plans. Because ITGs are not treated as States for Social Security taxes under IRC § 7871 or any other IRC provision, ITGs and tribal police officers who participate in a State pension plan are still responsible for their respective employer and employee portions of Social Security tax. This creates an inequity that can impede the ITG's ability to recruit and retain police officers, places an economic burden on the ITG attempting to address crime on tribal lands, and thereby frustrates congressional intent to deal with this issue. It also undermines ITG taxpayers' *right to a fair and just tax system*.

### Analysis

Congress enacted IRC § 7871 and acknowledged that, in many respects, ITGs function like States and should therefore be treated like them for certain federal tax purposes. Congress has also decided that ITGs should be treated as States with regard to FUTA taxes. Regarding Social Security tax law, Congress has provided a Social Security tax coverage exception for State employees who are covered by a State retirement plan. ITGs face high levels of crime, particularly violent crime, on tribal lands. In response, Congress enacted the Tribal Law and Order Act of 2010 to encourage the hiring of more law enforcement officers for Indian tribal lands and provide additional tools to address critical public safety needs. To facilitate recruitment and retention, an ITG may also enter into an agreement with a State in which it is located to allow tribal police officers to participate in the State's retirement plan. However, if tribal police officers choose to participate in a State retirement plan, they and the ITG must still pay Social Security taxes in addition to any contributions they make to the State retirement plan. Yet, as State employees, their State police officer counterparts are excepted under the IRC from Social Security taxes if they participate in a State retirement plan. This places an unfair economic burden on ITGs and is a disincentive for tribal police officers to work on Indian tribal lands. As a result, ITGs may not be able to recruit and retain tribal police officers by offering participation in favorable State pension plans.

### Recommendation

The National Taxpayer Advocate recommends that Congress amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as a "State."

**LR #7      TAXPAYER RIGHTS: Toll the Time Period for Financially Disabled Taxpayers to Request Return of Levy Proceeds to Better Protect Their Right to a Fair and Just Tax System****Problem**

Under Internal Revenue Code (IRC) § 6331, the IRS is authorized to collect outstanding tax by levying against taxpayers' non-exempt property and rights to property. If the IRS wrongfully levies the property of a third person (*i.e.*, property in which the taxpayer has no rights and that is not otherwise subject to the Federal tax lien), it is lawful for it to return the property to that person within certain time periods. The IRS may return levied property to a taxpayer, however, only if certain conditions are met, and it must (by regulation) return levied property to the taxpayer if the levy is in violation of the law. Under IRC § 6343(b), the IRS may only return money levied upon or money received from sale of property within nine months from the date of levy. A person other than the taxpayer may file a civil suit against the United States for a wrongful levy under IRC § 7426, but the action must be brought within nine months from the date of the levy. Therefore, if a third party or taxpayer files an administrative request with the IRS or if a third party files a civil suit under IRC § 7426 for return of levy proceeds after the nine-month period has expired (without having timely filed a claim), neither the IRS nor the court may allow such a claim. Unlike the statutory time period for filing a refund claim under IRC § 6511, there is no provision that tolls the nine-month time period when a third-party or taxpayer has a physical or mental impairment. The absence of suspension of the nine-month time period when a person is financially disabled fails to protect the rights to a fair and just tax system, to privacy, to pay no more than the correct amount of tax, and to appeal an IRS decision in an independent forum.

**Analysis**

The law as currently written prevents the IRS and the courts from returning levied property in situations where the taxpayer, due to a physical or mental impairment, does not file a request for return of levied money or petition the court until after the nine-month period. This means that a taxpayer or third party who is impaired from requesting the levied amount be returned will lose that amount, even though the levy may have been wrongful, violated the law, or damaged the taxpayer's ability to pay the debt. Congress was concerned about similar outcomes in the context of filing a claim for refund and enacted IRC § 6511(h), which tolled the time period for filing a claim when a taxpayer was unable to manage his or her financial affairs due to a physical or mental disability (known as "financially disabled"). The concerns that led Congress to enact IRC § 6511(h) are equally applicable to the requests for return of levy proceeds.

**Recommendations**

The National Taxpayer Advocate recommends amending IRC §§ 6343(b) and 6532(c) to suspend their respective time periods for filing a claim for return of levy proceeds during any period in which an individual is financially disabled. The National Taxpayer Advocate also recommends the IRS adopt her 2013 recommendation to amend the definition of financial disability under IRC § 6511(h).

**LR #8 THE FRIVOLOUS RETURN PENALTY: Protect Good Faith Taxpayers by Expanding the Availability of Penalty Reductions, Establishing Specific Penalty Abatement Procedures, and Providing Appeal Rights****Problem**

Congress passed IRC § 6702 which, as currently formulated, generally imposes an immediately assessable \$5,000 penalty on tax returns adopting a position that the IRS has identified as frivolous or reflecting a desire to delay or impede the administration of Federal tax laws. This penalty was primarily intended to address protest returns and was not aimed at taxpayers making good faith mistakes on their returns, such as innocent mathematical or clerical errors. Over time, however, the number of frivolous positions specifically identified by the IRS has grown to over 50, some of which are interpreted sufficiently broadly as to encompass unintentional tax reporting errors and occasionally undermine Constitutional protections. As this expansion of the penalty has occurred, avenues for relief from inappropriate application of the penalty have proven too narrow to protect the rights of good faith taxpayers.

**Analysis**

Taxpayers can avoid application of the frivolous return penalty if they withdraw and correct their frivolous position within 30 days of receiving notice from the IRS. This timeframe, however, is simply too short for some unsophisticated taxpayers, and it should be expanded to a more reasonable length. Other relief mechanisms are similarly arbitrary in operation. The opportunity to reduce the penalty from \$5,000 to \$500 under IRC § 6702(d) is only available to the extent that a taxpayer has not already satisfied the penalty, including by means of an automatic or involuntary refund offset. This limitation is particularly problematic because no clearly defined procedures exist allowing an abatement of the penalty for reasonable cause and good faith. Further, taxpayers are no longer provided with the right to seek a review of the penalty within the IRS Office of Appeals.

**Recommendations**

The National Taxpayer Advocate recommends that Congress amend IRC § 6702(b)(3) to expand the notice period allowing taxpayers to correct their returns and avoid application of the frivolous return penalty from 30 days to 60 days and establish the same mechanism for correcting returns under IRC § 6702(a); amend IRC § 6702(d) to clarify that taxpayers will be eligible for reduction of the frivolous return penalty regardless of whether they have already satisfied the penalty; amend IRC § 6702 to establish the availability of a full penalty abatement for good faith and reasonable cause; and amend IRC § 6702 to provide that taxpayers will be entitled to obtain a post-assessment, prepayment, or postpayment review of frivolous return penalties within the IRS Office of Appeals.

## RECOMMENDATIONS TO MINIMIZE IRS WASTED RESOURCES AND REDUCE TAXPAYER BURDEN

### LR #9 **AFFORDABLE CARE ACT INFORMATION REPORTING: Allow Taxpayer Identification Number Matching for Filers of Information Returns Under IRC §§ 6055 and 6056**

#### Problem

The IRS relies on new information reports to verify data relevant to a number of provisions in the Patient Protection and Affordable Care Act of 2010 (ACA). Although the tax code requires health insurance providers and applicable large employers (ALE) to file information returns with the IRS reflecting specific information regarding health insurance coverage, the law does not permit these companies to verify taxpayer identification numbers (TINs) with the IRS prior to filing. Unlike information return filers who report payments subject to backup withholding, who can use the TIN matching program established under Internal Revenue Code (IRC) § 3406 and perfect TINs once the IRS advises them of any errors, health insurance providers and ALEs must rely on input from their customers and employees while still facing penalties for errors. The IRS expects to receive over 120 million information returns from health insurance providers and ALEs during the 2016 filing season.

#### Analysis

Information returns allow the IRS to cross-check taxpayer claims against third-party reports. In the case of ACA, health coverage and offers of coverage are contained on Forms 1095-B and 1095-C, which include information that helps facilitate administration of the law. If the information provided is inaccurate, it will inhibit the IRS's ability to accurately implement the ACA. The existing TIN matching program allows payors an opportunity to resolve inaccuracies prior to filing an information return, but it is limited to filers of returns reporting payments subject to backup withholding. An expansion of the TIN matching program to filers of Forms 1095-B and 1095-C will reduce errors in information reported, resulting in fewer inaccurate IRS notices and penalties, saving both taxpayer and IRS resources. If Congress expands the TIN matching program to include Form 1095-B and 1095-C, it would benefit the IRS, information return filers, and taxpayers by facilitating accurate reports.

#### Recommendations

The National Taxpayer Advocate recommends that Congress amend IRC §§ 6055 and 6056 to allow entities required to file information returns under these sections to verify TINs with the IRS prior to filing annual information returns.

**LR #10 EXEMPT ORGANIZATIONS (EOs): Require More Frequent Updates to Publicly Available Databases of EOs****Problem**

The IRS maintains a list of tax exempt organizations (EOs) on two publicly accessible online databases, the Exempt Organizations Business Master File (EO BMF) and Exempt Organizations Select Check (EO Select Check). When an EO fails to file an information return or notice for three consecutive years, its exempt status is automatically revoked, the IRS removes the EO from its online-published lists of EOs, and places it on a list of automatically revoked organizations. Unless the automatic revocation was due to IRS error, an automatically revoked organization must submit a new application to have its exempt status reinstated. Even if the IRS promptly reinstates the organization or discovers its error, IRS databases will not immediately reflect the organization's restored exempt status because the IRS only updates its databases monthly, except in January when the databases are not updated at all. Therefore, reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status, which may be an existential issue for some organizations.

**Analysis**

The IRS recognizes the reliance on the EO BMF and EO Select Check databases by individual donors, who use them to verify that their contributions will be tax deductible, and private foundations, which use them to verify that they are making a grant to a qualifying public charity. However, the IRS does not update these databases in a timely manner, causing reinstated automatically revoked organizations to potentially lose out on donations or grants. In addition, these databases are not updated at all from the second Monday in December until the second Monday in February, a period that includes the critical year-end fundraising push. The number of automatic revocation reinstatement cases during this gap period exceeded 2,500 in both FYs 2014 and 2015, and more than 70 percent of these cases were 501(c)(3) organizations. A determination letter from the IRS or a phone call to the IRS (where callers face lengthy hold times, courtesy disconnects, and poor levels of service) may not satisfy a potential donor or grantor. Many donors or grantors may simply "move on" and make a donation or grant to an organization that appears on EO Select Check and EO BMF. Other donors or grantors have operational guidelines that require the EO to be listed on the IRS databases before consideration for donations or grants.

**Recommendations**

The National Taxpayer Advocate recommends that Congress amend Internal Revenue Code § 6033 to require the IRS to update EO BMF and Select Check on a weekly basis as is the case for Form 990-N updates; and implement an emergency process that, even when there is weekly updating, allows for manual database updates within 24 hours of the restoration of exempt status. Until appropriate programming changes can be made, Congress should direct the IRS to update EO Select Check manually.

**LR #11 BASIS REPORTING: Reduce Taxpayer Burden and Improve Tax Compliance by Requiring Partnerships and S Corporations to Report Each Partner's or Shareholder's Adjusted Basis Annually on Schedules K-1**

**Problem**

Pass-through entities such as partnerships and S corporations are becoming the preferred way to structure businesses. The proportion of businesses organized as pass-through entities and their business receipts has increased substantially. Between 1980 and 2011, the number of pass-through business tax returns has increased by approximately 294 percent from nearly two million returns to about 7.6 million returns. By comparison, the number of returns filed by C corporations, which are not pass-through entities, decreased by about 25 percent. Partnerships and S corporations are required to furnish to each of their partners and shareholders a Schedule K-1 that reports the partner or shareholder's allocable share of the income, gain, or loss during the taxable year and to file a copy with the IRS. The Schedule K-1 does not include a partner's or shareholder's adjusted basis in the partnership interest or stock. Taxpayers must calculate adjusted basis annually, even though there is no taxable event until the sale or liquidation of the interest or stock. Taxpayers often lack the specialized knowledge needed to accurately calculate basis, which results in errors and can lead to an overstatement of basis and underpayment of tax, or an understatement of basis and overpayment of tax.

**Analysis**

Determining the correct tax basis for pass-through entities is no easy task. Subchapter K, which covers partnership taxation, contains some of the most complicated computations in the Internal Revenue Code, closely followed in complexity by the sections pertaining to computing the tax basis for an S corporation interest.

Owners of pass-through entities often hold their interest long-term and do not keep adequate records of the annual changes. Even when shareholders and partners do keep complete records, the process of computing basis changes is exceedingly complex and challenging, which is overwhelming to taxpayers. There are technical issues to address when requiring the reporting of annual adjusted basis, such as an unknown starting basis due to private party sale, inheritance, or gift; while these issues are challenging, they are nonetheless resolvable and will minimize burden and mistakes made by partners and shareholders.

**Recommendations**

The National Taxpayer Advocate recommends that due to the complexity of pass-through basis computations and the inconsistent reporting of adjusted basis, Congress should require annual adjusted basis reporting on Schedule K-1s issued to each partner or shareholder.

**LR #12      HARSHIP WITHDRAWALS: Provide a Uniform Definition of a Hardship Withdrawal From Tax-Advantaged Retirement Arrangements****Problem**

The Internal Revenue Code (IRC) contains a myriad of tax-advantaged arrangements to encourage taxpayers to save for retirement. Some allow participants to receive an early distribution in cases of financial hardship, such as a medical emergency. However, there is no uniform definition of “hardship” that would enable a participant to easily determine when an early withdrawal is allowable. Further, even if a tax-advantaged retirement arrangement allows for a hardship withdrawal, participants must deal with inconsistent rules for triggering the ten percent additional tax for early withdrawal imposed by IRC § 72(t).

**Analysis**

Some tax-advantaged retirement arrangements allow participants to take an early distribution upon the event of a hardship without being subject to the ten percent additional tax imposed by IRC § 72(t). However, these various arrangements do not uniformly apply these so-called “hardship withdrawal” provisions. The type of plan a taxpayer is participating in should not impact the taxpayer’s ability to receive a hardship withdrawal. By establishing uniform rules regarding the availability and tax consequences of hardship withdrawals, Congress will reduce complexity and eliminate meaningless distinctions between the types of tax-advantaged retirement arrangements that may be offered by different types of employers.

**Recommendations**

The National Taxpayer Advocate recommends that Congress establish uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged retirement arrangements. Hardship withdrawals should be permitted when a participant is faced with an unforeseeable emergency or severe financial hardship. Examples of unforeseeable emergency or severe financial hardship may include:

- Expenses for medical care incurred by the employee, the employee’s spouse, or dependents;
- Payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence;
- Loss of property due to casualty;
- Basic living expenses of low income taxpayers (those at or below the
- 250 percent of the federal poverty line); or
- Financial hardship resulting from an extended period of unemployment.
- The National Taxpayer Advocate further recommends that such hardship distributions be made exempt from the ten percent additional tax imposed by IRC § 72(t).

## RECOMMENDATIONS TO IMPROVE THE WHISTLEBLOWER PROGRAM

### LR #13 **WHISTLEBLOWER PROGRAM: Enact Anti-Retaliation Legislation to Protect Tax Whistleblowers**

#### Problem

In recognition of the valuable role whistleblowers can play in detecting underpayments of tax, and to encourage whistleblowers to come forward, the Internal Revenue Code (IRC), like the False Claims Act, permits awards to those who report wrongdoing. However, the IRC, unlike the False Claims Act and unlike whistleblower statutes that apply in other areas of the law, does not protect tax whistleblowers from retaliation. This lack of protection could impede employees, who may have unique skills and insights, from investigating and ascertaining whether their employers underpay taxes, and from reporting underpayments to the government. It may also impede whistleblowers who do come forward from pursuing administrative and judicial review of the IRS's award determination.

#### Analysis

The False Claims Act provides for a civil suit against a person who “knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval” to the government, and allows whistleblowers to share in the collected proceeds from such a suit. In 1986, Congress added an anti-retaliation provision to the False Claims Act entitling affected whistleblowers “to all relief necessary to make that employee, contractor, or agent whole.” Relief may include reinstatement, recovery of twice the amount of back pay (with interest on the back pay), and compensation for any special damages, including litigation costs and reasonable attorneys' fees. The False Claims Act does not apply to tax fraud. The whistleblower provision in IRC § 7623 was amended in 2006 to encourage tax whistleblowers to come forward, such as by providing for Tax Court review of the IRS's award determination. The Tax Court recognized that whistleblowers may face serious threats of retaliation and formalized its procedures for allowing a whistleblower to proceed anonymously. However, neither IRC § 7623 nor any other IRC provision contains an anti-retaliation provision. Faced with the possibility of retaliation for which the IRC provides no remedy, tax whistleblowers may be reluctant to investigate or report tax underpayments. The lack of an anti-retaliation provision may undermine Congress's efforts to encourage tax whistleblowers, and may have a chilling effect on whistleblowers' right to pursue review of the IRS's award determination. Providing protection from retaliation to tax whistleblowers would place them on similar footing as whistleblowers in other areas of the law, would further Congress's objective of encouraging them to come forward, and would support their right to seek review of the IRS's award determination.

#### Recommendation

The National Taxpayer Advocate recommends that Congress add a new provision to the IRC modeled on the anti-retaliation provisions of the False Claims Act.

**LR #14 WHISTLEBLOWER PROGRAM: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirement of IRC § 6103(p)**

**Problem**

Whistleblowers may legitimately acquire return information from the IRS pursuant to an exception to the nondisclosure rules of Internal Revenue Code (IRC) § 6103, such as IRC § 6103(k)(6) (“investigative disclosures”) or (h)(4) (in an administrative proceeding), yet IRC § 6103 does not generally restrict disclosures by whistleblowers. Whistleblowers are also not subject to the safeguarding requirements of IRC § 6103(p). These conditions undermine taxpayers’ fundamental *right to confidentiality*, which may in turn undermine voluntary reporting and compliance with the tax laws.

**Analysis**

IRC § 7431 authorizes civil suits for damages for the knowing or negligent inspection or disclosure of a taxpayer’s return or return information “in violation of any provision of section 6103,” and thus does not generally allow a taxpayer to bring suit against a whistleblower who re-discloses the taxpayer’s return information. IRC §§ 7213 and 7213A impose criminal liability for willful unauthorized disclosure or inspection of return information but do not apply to tax whistleblowers who acquire return information pursuant to IRC § 6103(k)(6) or (h)(4). The amount of statutory damages (\$1,000) and the maximum fine (\$5,000) under these provisions have remained unchanged for decades: even if these provisions applied, they would not adequately redress the injury that results from whistleblowers’ re-disclosure of return information or aid in the enforcement of the confidentiality rules.

**Recommendations**

The National Taxpayer Advocate recommends that Congress should amend IRC §§ 7431, 7213, and 7213A to provide that any whistleblower (*i.e.*, a person making a claim for award under IRC § 7623) or legal representative of a tax whistleblower who receives a taxpayer’s return or return information pursuant to an exception under IRC § 6103 is subject to the civil and criminal penalty provisions of IRC §§ 7431, 7213, and 7213A for the unauthorized inspection or disclosure of that information. Congress should increase the amount of statutory damages available under IRC § 7431 to a more substantial amount, such as \$5,000, for disclosures by tax whistleblowers seeking or obtaining an award pursuant to IRC § 7623(b) and increase the maximum amount of fines under IRC §§ 7213 and 7213A to more substantial amounts, such as \$20,000 and \$1,500, respectively. Congress should amend IRC § 6103(p) to make tax whistleblowers subject to its safeguarding requirements.

**LR #15 WHISTLEBLOWER PROGRAM: Amend IRC §§ 7623 and 6103 to Provide Consistent Treatment of Recovered Foreign Account Tax Compliance Act (FATCA) and Report of Foreign Bank and Financial Accounts (FBAR) Penalties for Whistleblower Award Purposes**

**Problem**

The Foreign Account Tax Compliance Act (FATCA) and Report of Foreign Bank and Financial Accounts (FBAR) statutory regimes allow the IRS to recover separate penalties for the same failure to report a foreign bank account. However, for purposes of making awards to whistleblowers under Internal Revenue Code (IRC) § 7623, proceeds from recovered FATCA penalties are taken into account, but proceeds from recovered FBAR penalties are not. Information the IRS obtains in an FBAR investigation may not be return or return information under IRC § 6103 but may be protected from disclosure under Title 31. The IRS may not be permitted to share information it gathers in a Title 31 investigation with a whistleblower, leaving the whistleblower without a basis for evaluating a proposed award, or the denial of one.

**Analysis**

Under provisions found in Title 31 of the U.S. Code, failing to report a foreign bank account may trigger a penalty equal to the greater of \$100,000 or 50 percent of the account balance, with no ceiling on the amount of the penalty. Under provisions found in the IRC, which is Title 26, a person who fails to make the required disclosure on Form 8938, as required by FATCA, is subject to a penalty of \$10,000, which may rise as high as \$60,000. The IRS's position is that penalty amounts recovered for FATCA violations, but not those recovered for FBAR violations, are taken into account in determining the amount of a whistleblower award. As the whistleblower in one Tax Court case asserted, FBAR penalties may far exceed amounts recovered under Title 26. Whistleblowers would have more of an incentive to report undetected foreign bank accounts if FBAR penalties were included in the award amount. Moreover, information from whistleblowers may be the only way for IRS to learn of foreign accounts where the account meets the FBAR but not the FATCA reporting thresholds or where FATCA third-party reporting rules have been circumvented.

**Recommendations**

The National Taxpayer Advocate recommends that Congress should amend IRC § 7623 to provide that the terms “proceeds of amounts collected” and “collected proceeds” include civil penalties recovered pursuant to 31 U.S.C. § 5321 for failing to file an FBAR. Information the IRS receives as part of its FBAR investigation should be designated as return or return information, within the meaning of IRC § 6103, subject to the same limitations on disclosure, and whistleblowers should be subject to existing penalties for the unauthorized use or re-disclosure of such information.

## THE MOST LITIGATED ISSUES

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Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(x) requires the National taxpayer advocate to include in her annual report to congress the ten tax issues most litigated in the federal courts, classified by the type of taxpayer affected. The cases we reviewed were decided during the 12-month period that began on June 1, 2014, and ended on May 31, 2015.

### **MLI #1 Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)**

Internal Revenue Code (IRC) §§ 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations caused an underpayment of tax, or if an underpayment exceeded a computational threshold called a substantial understatement, respectively. IRC § 6662(b) also authorizes the IRS to impose five other accuracy-related penalties.

### **MLI #2 Trade or Business Expenses Under IRC § 162 and Related Sections**

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998. We identified 99 cases involving a trade or business expense issue that were litigated between June 1, 2014 and May 31, 2015. The courts affirmed the IRS position in 57 of these cases or about 58 percent, while taxpayers fully prevailed in 11 cases or about 11 percent. The remaining 31 cases, or 31 percent, resulted in split decisions.

### **MLI #3 Summons Enforcement Under IRC §§ 7602, 7604, and 7609**

Pursuant to IRC § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability. To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information. If a person summoned under IRC § 7602 neglects or refuses to obey the summons; to produce books, papers, records, or other data; or to give testimony as required by the summons, the IRS may seek enforcement of the summons in a United States district court.

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it. Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because the government, rather than the taxpayer, initiates the litigation. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons. The burden on the taxpayer to establish the illegality of the summons is generally heavy. When challenging the summons's validity, the taxpayer must generally provide "some credible evidence" supporting an allegation of bad faith or improper purpose. The taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons only when the taxpayer can point to specific facts or circumstances that plausibly raise an inference of bad faith. Naked allegations of improper purpose are not enough; however, because direct evidence of IRS's bad faith "is rarely if ever available," circumstantial evidence can suffice to meet that burden.

We identified 84 federal cases decided between June 1, 2014 and May 31, 2015 involving IRS summons enforcement issues. The government was the initiating party in 59 cases, while the taxpayer was the

initiating party in 25 cases. Overall, taxpayers fully prevailed in two cases, while one case was split. The IRS prevailed in the remaining 81 cases.

#### **MLI #4 Gross Income Under IRC § 61 and Related Sections**

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress. For this report, we reviewed 80 cases decided between June 1, 2014 and May 31, 2015. The majority of cases involved taxpayers failing to report items of income, including some specifically mentioned in IRC § 61 such as wages, interest, dividends, and annuities.

#### **MLI #5 Appeals from Collection Due Process Hearings Under IRC §§ 6320 and 6330**

The IRS Restructuring and Reform Act of 1998 (RRA 98) created Collection Due Process (CDP) hearings to provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. A CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy; including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.

Taxpayers have the right to judicial review of Appeals' determinations, if they timely request the CDP hearing and timely petition the United States Tax Court. Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.

Since 2001, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 79 opinions on CDP cases during the review period of June 1, 2014, through May 31, 2015. Taxpayers prevailed in full in 11 of these cases (nearly 14 percent) and, in part, in three others (nearly four percent). Of the 14 opinions where taxpayers prevailed in whole or in part, five taxpayers appeared *pro se* and nine were represented.

The cases discussed demonstrate that CDP hearings serve an important role in providing taxpayers with a venue to raise legitimate issues before the IRS deprives them of property. Many of these decisions shed light on substantive and procedural issues.

CDP hearings are particularly valuable because they provide taxpayers with an enforceable remedy with respect to several rights articulated in the Taxpayer Bill of Rights, which was adopted by the IRS in 2014 in response to National Taxpayer Advocate recommendations. In particular, by providing an opportunity for a taxpayer to challenge the underlying liability and propose alternatives to the collection action, the CDP hearing enables the taxpayer's *right to challenge the IRS's position and be heard*. If the taxpayer does not agree with the Appeals determination, he or she may file a petition in Tax Court, which furthers the taxpayer's *right to appeal an IRS decision in an independent forum*. Lastly, since the Appeals Officer must consider whether the IRS's proposed collection action balances the overall need for efficient collection of taxes with the legitimate concern that the IRS's collection actions are no more intrusive than necessary, the CDP hearing protects a taxpayer's *right to privacy* while also ensuring the taxpayer's *right to a fair and just tax system*.

**MLI #6**      **Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Penalty Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654**

We reviewed 63 decisions issued by federal courts from June 1, 2014 to May 31, 2015 regarding the additions to tax for:

- Failure to file a tax return by the due date under IRC § 6651(a)(1);
- Failure to pay an amount shown as tax on a return under IRC § 6651(a)(2); or
- Failure to pay installments of the estimated tax under IRC § 6654.

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Eighteen cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; 44 involved the failure to file or failure to pay penalties; one case involved only the estimated tax penalty.

The IRS imposes the failure to file and failure to pay penalties unless the taxpayer can demonstrate the failure is due to reasonable cause and not willful neglect. The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions. Taxpayers were unable to avoid a penalty in 59 of the 63 cases.

**MLI #7**      **Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403**

IRC § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or subject any of the delinquent taxpayer’s property to the payment of tax. We identified 44 opinions issued between June 1, 2014 and May 31, 2015 that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 40 of these cases. The total number of cases represents an approximate 15 percent decrease from the previous year.

**MLI #8**      **Charitable Deductions Under IRC § 170**

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes for contributions of cash or other property to or for the use of charitable organizations. To take a charitable deduction, taxpayers must contribute to a qualifying organization and substantiate contributions of \$250 or more. Litigation generally arises over one or more of the following four issues:

- Whether the donation is made to a charitable organization;
- Whether contributed property qualifies as a charitable contribution;
- Whether the amount taken as a charitable deduction equals the fair market value of the property contributed; and
- Whether the taxpayer has substantiated the contribution.

We reviewed 28 cases decided between June 1, 2014 and May 31, 2015, with charitable deductions as a contested issue. The IRS prevailed in 18 cases, taxpayers in seven cases, and the remaining three cases resulted in split decisions. Taxpayers represented themselves (appearing *pro se*) in 14 of the 28 cases

(50 percent), with taxpayers prevailing in four cases, the IRS in nine cases, and the remaining one resulting in a split decision.

### **MLI #9 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions**

From June 1, 2014 through May 31, 2015, the federal courts issued decisions in at least 22 cases involving IRC § 6673 “frivolous issues” penalty, and at least four additional cases involving analogous penalties at the appellate level. These penalties are imposed against taxpayers for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal. In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future. Nonetheless, we included these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

### **MLI #10 Relief from Joint and Several Liability Under IRC § 6015**

Married couples may elect to file their federal income tax returns jointly or separately. Spouses filing joint returns are jointly and severally liable for any deficiency or tax due. Joint and several liability permits the IRS to collect the entire amount due from either taxpayer.

IRC § 6015 provides three avenues for relief from joint and several liability. Section 6015(b) provides “traditional” relief for deficiencies. Section 6015(c) also provides relief for deficiencies for certain spouses who are divorced, separated, widowed, or not living together by allocating the liability between the spouses. Section 6015(f) provides “equitable” relief from both deficiencies and underpayments, but only applies if a taxpayer is not eligible for relief under IRC § 6015(b) or (c).

We identified 24 federal court opinions involving relief under IRC § 6015 that were issued between June 1, 2014 and May 31, 2015. Courts granted relief to the requesting spouse in seven cases (29 percent). The IRS prevailed in 15 cases (63 percent). The remaining two cases resulted in split decisions. Significant issues that arose this year include: (1) the Tax Court’s jurisdiction over requests for equitable relief, and (2) intervening spouses opposing equitable relief after the IRS conceded that requesting spouses were entitled to relief at trial.

## VOLUME 2: TAS RESEARCH AND RELATED STUDIES

### #1 Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ

On July 1, 2014, the IRS released Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. The application allows certain organizations to attest that they meet requirements for exempt status and does not require any supporting documentation or substantiation of those attestations. TAS undertook a study to examine a representative sample of organizations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ was approved by the IRS. The objective of the study is to ascertain the extent to which approved organizations actually satisfied the organizational test, a legal requirement for qualification as an IRC § 501(c)(3) organization, and the extent to which approved organizations, whether they met the organizational test or not, were eligible to apply for exempt status using Form 1023-EZ. The study findings for the population studied are statistically valid at the 95 percent confidence level with a margin of error no greater than +/-5 percent.

The study found that for organizations in 20 states that make articles of incorporation viewable online at no cost:

- Thirty-seven percent do not meet the organizational test for qualification as an IRC § 501(c)(3) organization;
- Thirty percent of these organizations' articles of incorporation do not have an acceptable purpose clause;
- Twenty-three percent of these organizations' articles of incorporation do not provide for distribution of assets upon dissolution as the law requires;
- It takes on average less than three minutes to review articles of incorporation and determine whether the organizational test is met and in over 90 percent of the cases, it took five minutes or less; and
- Only about half of the organizations maintain websites that could provide additional information.

Thus, the IRS approves a significant portion of Form 1023-EZ applications from organizations that do not meet the legal requirements for qualification as IRC § 501(c)(3) organizations. To the extent these organizations receive amounts that should be treated as taxable receipts they are improperly subsidized by other taxpayers. Eight organizations in our sample filed Form 1120, *U.S. Corporation Income Tax Return*, for at least one tax period prior to obtaining recognition of exempt status, which raises the question of whether the organizations merely continued to operate a for-profit entity in the guise of an exempt organization. To the extent organizations receive contributions deducted by the donor, tax dollars are inappropriately diverted. Moreover, the skeletal Form 1023-EZ, the brevity of the annual report required of these organizations, and the probability that the organizations will not have a website result in a disturbing lack of information about them, undermining the public's and the IRS's ability to effectively monitor this segment of the exempt organization population.

## #2 IRS Collectibility Curve

### Introduction

IRS assigns delinquencies to Taxpayer Delinquent Account (TDA) status within four to five months after it assesses the liability and after sending the taxpayer a series of notices. However, the volume of TDAs may delay collection actions from occurring for some time. Additionally, TDAs are often prioritized for action based on the balance due. Since older TDAs with more accumulated penalties and interest have greater balances, the IRS collection functions often work these cases first. The collection industry believes that liabilities must be collected within three years, if they are to recoup any significant amount of the delinquency.

### Objectives

We identified nine objectives to explore the relationship between the age of a TDA and the dollars that the IRS collects on these liabilities. These objectives explore the dollars collected as TDAs age, and differentiate between dollars collected from subsequent payments and dollars collected by offset. We also explore subsequent payments and offsets by various categories of the balance due amount, the type of assessment, and the accumulation of penalties and interest. Specifically, for Individual Master File (IMF) liabilities reaching TDA status, we:

- Determine amounts collected from subsequent payments on delinquencies for the three years after the liability reaches TDA status;
- Quantify the dollars from subsequent payments collected during the entire ten-year statutory period for collection;
- Delineate the dollars collected from offsets of other overpayments and compare them to collections from other subsequent payments;
- Determine how the collection of liabilities varies by the amount of the delinquency;
- Determine if the rate of collection varies between self-reported liabilities and additional assessments;
- Quantify how penalty and interest cause the liability from a tax assessment to increase the total balance due;
- Determine the percent of liabilities abated by the IRS and if the percent abated varies by the source of assessment;
- Examine the percent of cases resolved during the ten-year statutory collection period ; and
- Determine if the percent of TDA dollars collected varies by Collection channel.

### Methodology

TAS Research examined the IMF Accounts Receivable Dollar Inventory (ARDI) to determine how dollars collected fluctuate over time. We looked at delinquencies that entered TDA status from 2003 through 2012. We analyzed liabilities entering TDA status in 2003, 2004, and 2005 for ten years. We analyzed the later years through 2014. We focused initially on payments received during the first three years after the accounts entered TDA status. To examine payments over the ten-year collection statute and to better differentiate between subsequent payments and offsets from other taxpayer overpayments, we used transaction code data from the IMF. This allowed us to distinguish between payments and offsets, as well as to quantify abatements. Transaction codes were also used to classify assessed interest and penalties. We classified a liability by the first calendar year when it reached TDA status. If a delinquent

module left and returned to TDA status, we continued to classify it by the first year the IRS assigned the liability to TDA status.

We used the major source of assessment (from the ARDI file) to classify the source of assessment. Sometimes, a liability is comprised of more than one type of assessment. For example, a liability might be comprised of a self-reported assessment and an audit assessment. In this case, the type of assessment is the one most significantly contributing to the balance owed. We determined whether the IRS assigned a TDA liability to ACS, collection queue, or Cff by the Taxpayer Service Returns Processing Category (TRCAT) code, which differs depending on where a liability is located in the collection stream.

## Findings

The IRS is more successful at collecting liabilities soon after TDA assignment. This result is similar to the experience of private collection agencies. Dollars do continue to be collected throughout the life of the ten-year statutory collection period; however, the payment rate slows significantly. As one might expect, the IRS is also more successful in its collection of self-reported assessments and smaller TDA balances. The IRS continues to deal with a high number of bad assessments that hamper its TDA collections. While we are heartened by the IRS's willingness to abate improper (or uncollectible) assessments, we wonder how many taxpayers pay assessments for which they are not liable, before the IRS even assigns the delinquency to TDA status. We have distilled the findings from the nine objectives into nine specific conclusions.

- Dollars collected in aggregate and as a percent of the balance due decrease significantly during the first three years after the IRS assigns a liability to TDA status. The decline in the module balance also slows significantly during these first three years.
- When continuing to look at the collection of liabilities after the third year of the initial TDA assignment, collection continues to dwindle, and the reduction in the module balance declines almost completely by the expiration of the collection statute.
- Overall, dollars collected through the offsets of other overpayments are significantly less than dollars collected through subsequent payments. However, dollars collected through offsets decrease much less precipitously than dollars collected from subsequent payments as time elapses from the initial TDA assignment.
- Delinquent modules with balances due not in excess of \$5,000 comprise the vast majority of TDAs. However, over 80 percent of the total amount due resides with TDAs with balances greater than \$5,000. The IRS collects both a higher percentage of subsequent payments and offsets in the lowest balance due categories. Collection and offsets as a percent of the balance due progressively decrease as the balance due rises.
- The percent of the TDA balance collected is significantly greater for self-reported liabilities than when the IRS makes additional assessments. However, AUR assessments result in a greater percentage of dollars collected through offsets.
- Penalty and interest significantly increase the balance owed by taxpayers, particularly when the underlying balance remains unresolved for several years.
- The IRS abates between a quarter and a third of TDA liabilities and 40 to 50 percent of its substitute for return assessments. It also abates a high proportion of AUR assessments.
- The IRS completely resolves most of its TDA modules within the ten-year collection statute, with a resolution rate of about 80 percent for TDAs assigned in 2003 and 2005. Unfortunately, the

percent of TDAs resolved has generally declined thereafter. Additionally, the balance owed on these delinquencies has been reduced by less than 50 percent.

- Automated Collection System (ACS) realizes the largest percentage of TDA balances collected by subsequent payment and offset. While the percent of dollars abated is high in all TDA collection channels, the abatement rates are significantly higher in the queue and Collection Field function than in ACS. However, even controlling for abatements, ACS collects a greater percentage of the liabilities assigned to it compared to the other TDA functions.

## #3 Audit Impact Study

### Introduction

The IRS audits roughly 1.5 percent of all self-employed individual income taxpayers annually. In fiscal year 2014, the direct effect of these audits was over \$3 billion in recommended additional tax assessments, although not all of the recommended amount will ultimately be collected (Internal Revenue Service, 2015). Less is known, however, about the indirect long-term effect of audits on subsequent taxpayer reporting behavior. Behavioral changes may either undermine immediate gains in tax collections or further increase the revenue returns of audits. Depending on risk attitudes, norms, moral perceptions, and perhaps most importantly, the subjective appraisal of the audit, enforcement activity has the potential to increase or decrease the willingness to comply with the law and to cooperate with the IRS in the future.

### Objective

This report evaluates the impact of enforcement activity on the subsequent compliance behavior of nonfarm self-employed taxpayers. Through a statistical comparison of administrative data for a random sample of 2,204 Schedule C filers with under \$200,000 in total gross receipts who were audited subsequent to filing their TY2007 returns with data for a control sample of 4,705 who were not audited, we are able to estimate the short- and long-term impact of audits on tax collections. In our empirical analysis, we distinguish between (seemingly) compliant and (seemingly) non-compliant taxpayers, as the audit response likely differs between these groups. A “direct deterrent effect” (Alm *et al.*, 2009) of additional tax assessments potentially increases the compliance of caught evaders. The response of compliant taxpayers to enforcement activity is ambiguous, however. Audits could be seen as a justified means to enforce the law, increasing the trust in the state and the willingness to comply voluntarily. A coercive experience might have the opposite outcome.

### Methodology

We rely on a range of non-experimental estimators to refine this comparison and quantify the magnitude of the short- and long-run audit impact. These include the difference-in-differences estimator, variants of this method that account for sample selection and attrition, as well as less parametric propensity score matching methods. While propensity score matching overcomes observable differences between our experimental groups, the difference-in-differences approach accounts for unobservable, time-constant effects. It is reassuring that these two alternative approaches yield similar results.

### Findings

Our empirical results provide robust evidence that audits have important long-term revenue implications. Three years after an audit, the average small business taxpayer reports around 20 percent more income. The indirect long-term effects thus clearly add to the static gain of additional tax assessments. However, by differentiating the response of compliant and non-compliant taxpayers, we find that there is scope for improving the revenue efficiency of audits. Our more nuanced analysis of the behavioral response to an audit shows that (seemingly) non-compliant taxpayers increase their subsequent reporting of taxable income dramatically (+120 percent), while (seemingly) compliant taxpayers actually report less (-35 percent). Several explanations seem plausible for this finding. The positive impact on (seemingly) non-compliant taxpayers is likely due to some kind of specific deterrent effect (Alm *et al.*, 2009). Understanding the observed reduction in reported income among (seemingly) compliant taxpayers is probably even more important.

### Conclusion

The estimates indicate an enduring effect of audits on non-compliant taxpayers. On average, non-compliant taxpayers increase their reported taxable income by 250 percent following an audit. Three years after the audit, the effect is still substantial with an average increase of 120 percent. Importantly, the results also indicate that audits have a detrimental long-term impact on the reporting behavior of compliant taxpayers. Three years after having undergone enforcement activity, compliant taxpayers report around 35 percent less in taxable income than the control group. The difference is significant at the one percent level. When we employ a less nuanced model that does not distinguish compliant from non-compliant audited taxpayers, we find that, on net, reported taxable income for this combined group increases by roughly 20 percent three years after an audit.

## #4 Understanding the Hispanic Underserved Population

### Introduction

Hispanics are a growing population within the United States. In 1960, Hispanics comprised only 3.5 percent of the U.S. population with 6.3 million persons. In 2013, Hispanics made up 17.1 percent of the U.S. population, with 54 million individuals. Based on the latest projections from the U.S. Census Bureau, there will be 119 million Hispanics by 2060. Studying the characteristics and the ways in which Hispanics interact with the tax system may provide valuable information about the needs and preferences of other groups of taxpayers sharing common characteristics, *e.g.*, taxpayers whose families have recently immigrated from other countries or who have limited English proficiency.

Since 2002, TAS has worked with outside research organizations to identify and understand the demographics and needs of taxpayers who are underserved by TAS. To complement its prior research and ensure that TAS and the IRS are effectively serving U.S. Hispanics with limited English proficiency, TAS commissioned a new survey from Forrester Research to learn about the characteristics of Hispanic taxpayers who may have limited English proficiency (LEP) and may qualify for TAS assistance.

### Objectives

The primary purpose of this study was to quantify and analyze the Hispanic population potentially underserved by TAS, for which information was not available in prior Forrester Omnibus surveys. The survey aimed to understand the current Hispanic population, with specific objectives to:

- Obtain a detailed analysis of the current Hispanic population based on demographics, behavior, and attitudes;
- Evaluate Hispanic taxpayers' knowledge, beliefs, and perceptions of TAS and the IRS; and
- Provide an understanding of U.S. Hispanic taxpayers in poverty level groups through a holistic profile of their demographics and tax-related behaviors.

### Methodology

From October 2 through December 5, 2014, Forrester surveyed by phone 1,014 adults (age 18 or older) in the United States who self-identified as being of Hispanic or Latino origin (ethnicity). The survey employed a random digit dial that focused on High Density Hispanic Areas with Hispanic populations of 33 percent or higher, and included both landlines and wireless phones. Each interview lasted approximately 20 minutes, and was conducted in either English or Spanish, based on the respondent's preference.

### Findings

- Hispanics tended to have lower household incomes, were less likely to have a college education, and were younger than the general population of U.S. adults surveyed.
- The majority of Hispanics spoke Spanish at home and owned a smart phone. Language barriers are more likely to exist for Hispanics who have not filed tax returns in the past three years or who are within 400 percent of the poverty level. U.S. Hispanics may be more likely than the general U.S. adult population to use mobile devices, such as smartphones, to access the Internet.
- Hispanics may have limited interaction with the IRS due to their reliance on unenrolled tax return preparers to prepare returns and answer IRS questions, and based on their few reported problems with the IRS. Hispanics were much more likely to use an unregulated return preparer than U.S. taxpayers as a whole and were less likely to prepare their own tax returns as opposed to using

any kind of preparer. Seventy-seven percent of Hispanic taxpayers reported that their preparers answered IRS questions if the IRS had questions about their returns after filing. Only three percent of Hispanics reported that they or a member of their household “encountered any problem with the IRS related to filing or payment of Federal income taxes” in the last three years.

- Hispanics had greater awareness of their rights and trust in the IRS, compared with other U.S. persons. Eighty-eight percent of Hispanic respondents reported that they believe they have rights before the IRS versus 46 percent of U.S. adults. Sixty percent of Hispanic taxpayers said they generally trust the IRS and how it would handle a tax problem, compared to only 21 percent of U.S. taxpayers.
- TAS has opportunities for creating greater awareness about TAS among Hispanics and boosting their overall impression of the IRS. Hispanics were less likely than U.S. respondents overall to be aware of a specific department in the IRS that handles taxpayer problems, despite their greater awareness of their rights. When provided with a description of TAS, over half of Hispanics said they were likely to use it and almost two-thirds said they felt more positively about the IRS because an organization like TAS exists within it.

## Conclusion

Studying the characteristics of Hispanics provides valuable insights about how TAS and the IRS can better serve these taxpayers and suggests the need for further research studies. Given the widespread use of mobile technology by Hispanics, TAS has already made great strides in meeting their needs by having a mobile-friendly website that is designed to be viewed on a smartphone. However, the rest of the IRS could take steps to meet Hispanics’ needs by creating a mobile version of IRS.gov. The reduced English language proficiency among Hispanics suggests that TAS should concentrate on translating key parts of its website into Spanish.

Hispanic taxpayers’ heavy reliance on unregulated preparers supports the need for TAS’s continued advocacy to regulate tax return preparers. There are actions TAS can pursue to assist Hispanic taxpayers, such as working with the IRS to incorporate taxpayer rights training into the IRS’s voluntary continuing education program for preparers. However, such actions will not guard taxpayers against unscrupulous preparers, which Hispanics may be particularly vulnerable to, given their high usage of unregulated preparers.

Based on the data, additional research may provide further insights about how to assist Hispanic taxpayers. This survey was conducted during 2014, and Hispanics who responded may have been basing their answers on experiences prior to the IRS’s adoption of the Taxpayer Bill of Rights in 2014. The differences between Hispanics and U.S. persons will continue to inform the ways in which TAS provides service to Hispanic taxpayers and taxpayers as a whole.





YOUR VOICE AT THE IRS

