NATIONAL TAXPAYER ADVOCATE

ANNUAL REPORT TO CONGRESS

Volume 1

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www.TaxpayerAdvocate.irs.gov/2015AnnualReport

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

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, 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.[1]

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.[2] 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.

1 To see the conference agenda and abstracts of papers, visit 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 *non*compliant or who can "pay to play" will receive concierge-level service or personal attention.[3] 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.[4] 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[5]

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.[6] 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.[7] Here is a snapshot of what they experienced:

FIGURE 2, IRS Telephone Performance on Accounts Management and Select Lines[8]

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,[9] 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).[10] 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![11] At another point the wait time was 60 minutes.[12] 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,[13] 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.[14] 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.[15] 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.[16]

Power can be either coercive or legitimate.[17] 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 environment, you will have enforced compliance — which is very expensive, and often involves the use of both

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.

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).

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.[18] 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.[19] 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.[20]

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.[21] The online 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.

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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*).

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.

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.[22] 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.[23]

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 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

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*.

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),[24] where certain unregulated, untrained preparers prey on vulnerable taxpayers.[25] 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)[26] and the Foreign Account Tax Compliance Act (FATCA).[27] 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,[28] and it does not even begin to account for the additional costs the IRS incurred to implement the ACA and FATCA.

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

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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.

they are absolutely finalized.[29] 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.[30]

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.

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.

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 meanings 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."[1]

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.[2] 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) [a]	5,700,132	4,957,442
Average cycle time to work Individual Master File (IMF) Correspondence (non-Identity Theft) [b]	80 days	80 days
Inventory Overage (non-Identity Theft) [c]	67.0%	60.5%
Average cycle time to work IMF Correspondence (Identity Theft) [d]	106 days	80 days
Inventory Overage (Identity Theft) [e]	4.0%	0.7%
Business Correspondence Volume (adjustments) [f]	3,471,571	2,952,329
Average cycle time to work BMF Correspondence [g]	54 days	46 days
Inventory Overage [h]	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

1 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*).

2 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) [a]	242,404,425	246,523,200
Total Individual Income Tax Returns [b]	147,444,789	149,288,400
E-file Receipts (Received by 11/21/14, 11/20/15) [c]	125,821,000	128,784,000
E-file: Tax Professional [d]	62%	61%
E-file: Self Prepared [e]	38%	39%
Returns Prepared by:		
VITA/TCE/AARP [f]	3,322,582	3,519,006
Free File Consortium [g]	2,406,465	2,588,934
Fillable Forms [h]	478,501	355,080
IRS Taxpayer Assistance Centers (TACs) [i]	376	366
Number of Taxpayer Assistance ("Walk-In") Centers [j]	382	380
Number of TAC Contacts [k]	5,477,291	5,643,772
Total Calls to IRS [l]	100,667,411	116,679,405
Number of Attempted Calls to IRS Customer Service Lines [m]	86,171,857	101,507,150
Toll Free: Percentage of calls answered [n] (LOS)	64.4%	38.1%
Toll Free: Average Speed of Answer [o]	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 [p]	7.0 minutes	16.2 minutes
Practitioner Priority: Percentage of calls answered (LOS)	70.4%	47.6%
Practitioner Priority: Average Speed of Answer [q]	27.4 minutes	46.6 minutes
Tax Exempt/Government Entities Percentage of calls answered [r] (LOS)	67.6%	60.2%
Tax Exempt/Government Entities: Average Speed of Answer [s]	18.7 minutes	23.4 minutes
Toll Free Customer Satisfaction [t]	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 [a]	95.0%	95.0%
Toll-Free Accounts Accuracy[b]	96.2%	95.5%
Scope of Tax Law Questions Answered	TBD	TBD
Correspondence Examinations (Form 1040 Series)		
No change rate [c]	17.3%	17.3%
Agreed rate [d]	17.2%	16.3%
Non-response rate [e]	44.4%	48.3%
Percentage of cases appealed	TBD	TBD
Field Examinations (Form 1040 Series)		
No change rate [f]	15.5%	15.3%
Agreed rate [g]	46.6%	45.7%
Non-response rate [h]	0.3%	0.3%
Percentage of cases appealed	TBD	TBD

Office Examinations		
No change rate [i]	13.7%	13.5%
Agreed rate [j]	45.0%	44.7%
Non-response rate [k]	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) [a]	5,700,132	4,957,442
Average cycle time to work Individual Master File (IMF) Correspondence (non-Identity Theft) [b]	80 days	80 days
Inventory Overage (non-Identity Theft) [c]	67.0%	60.5%
Average cycle time to work IMF Correspondence (Identity Theft) [d]	106 days	80 days
Inventory Overage (Identity Theft) [e]	4.0%	0.7%
Business Correspondence Volume (adjustments) [f]	3,471,571	2,952,329
Average cycle time to work BMF Correspondence [g]	54 days	46 days
Inventory Overage [h]	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 [i]	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 [a]	113,608	113,870
Appeals Staffing (On-rolls) [b]	1,708	1,569
Number of States without an Appeals or Settlement Officer [c]	12	11
Customer Satisfaction of service in Appeals [d]	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) [a]	225 days	231 days
Average Days to Complete Correspondence Examination (EITC) [b]	243 days	221 days
Average Days to Reach Determination on Applications for Exempt Status [c]	291 days	83 days
Average Days for Exempt Organization Function to Respond to Correspondence [d]	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 [a]	0%	0%
Number of Low Income Taxpayer Clinics Funded [b]	131	132
Funds Appropriated for Low Income Tax Clinics [c]	$10 million	$10.3 million
Number of States and other jurisdictions with a Low Income Tax Clinic [d]	48	50
Number of Low Income Tax Clinic Volunteer Hours [e]	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 [a]	67,935	66,600
Offer in Compromise: Percentage of Offers Accepted [b]	41.9%	42.5%
Installment Agreements: Number of Individual & Business IAs [c]	3,011,636	2,986,121
Streamlined Installment Agreements Number of Individual & Business IAs [d]	2,857,043	2,567,623
Installment Agreements (CFf): Number of Individual & Business IAs [e]	52,619	52,053
Streamlined Installment Agreements (CFf): Number of Individual & Business IAs [f]	10,680	10,679
Number of OICs Accepted per Revenue Officer [g]	6.7	7.4
Number of IAs Accepted per Revenue Officer [h]	13.1	14.0
Percentage of Cases in the Queue (Taxpayers) [i]	15.6%	15.7%
Percentage of cases in the Queue (Modules)	25%	24.7%
Percentage of TDAs reported Currently Not Collectible - Tolerance [j]	18.2%	16.3%
Age of Delinquencies in the Queue [k]	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 [l]	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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INTRODUCTION: The Most Serious Problems Encountered by Taxpayers

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

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

To simply report on the top 20 problems would limit our effectiveness in focusing congressional, IRS, and public attention on critical issues. It would require us to repeat much of the same data and propose many of the same solutions year to year. Thus, the statute gives the National Taxpayer Advocate flexibility in selecting both the subject matter and the number of topics to be discussed and to use the report to put forth actionable and specific solutions instead of mere criticism and complaints.

METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. In many years, the National Taxpayer Advocate identifies a theme for the report that is reflected in the selection of issues. For example, this year's themes are:

- *IRS Future State Vision: Implications for Today and Tomorrow;*
- *Problems that Undermine Taxpayer Rights and Impose Taxpayer Burden;*
- *Problems that Waste IRS Resources and Impose Burden on Taxpayers; and*
- *Recommendations to Improve Earned Income Tax Credit Compliance.*

The 24 issues in this year's report are ranked according to the following criteria:

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

Finally, the National Taxpayer Advocate and the Office of Systemic Advocacy examine the results of the ranking on the remaining issues and adjust it where editorial or numerical considerations warrant a particular placement or grouping.

TAXPAYER ADVOCATE MANAGEMENT INFORMATION SYSTEM LIST

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy — using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2015, a period spanning October 1, 2014, through September 30, 2015.

USE OF EXAMPLES

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

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

RESPONSIBLE OFFICIALS

John A. Koskinen, Commissioner of Internal Revenue, and Members of the IRS Senior Leadership Team

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

During the past year-and-a-half, the IRS has devoted significant resources to creating a "future state" plan that details how the agency will operate in five years. The plan is explained and developed in a document known as a Concept of Operations (CONOPS). There are many positive components of the plan, including the goal of creating online taxpayer accounts through which taxpayers will be able to obtain information and interact with the IRS.[2]

However, the CONOPS also raise significant questions and concerns. Implicit in the plan — and explicit in internal discussion — is an intention on the part of the IRS to substantially reduce telephone and face-to-face interaction with taxpayers. The IRS is hoping that taxpayer interactions with the IRS through online accounts will address a high percentage of taxpayer needs. It is also developing plans to enable third parties like tax return preparers and tax software companies to do more to assist taxpayers for whom online accounts are insufficient — an approach that will increase compliance costs for millions of taxpayers.

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The only right in the Taxpayer Bill of Rights that is not directly affected by the IRS's future state planning is *the right to retain representation*.

2 For a more detailed assessment of online taxpayer 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*.

While online accounts should reduce taxpayer demand for telephone and face-to-face interaction to some degree, they are unlikely to reduce taxpayer demand dramatically. This is true 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.

Taxpayer demand for IRS services and assistance is high and has remained so for many years:

- Taxpayers place more than 100 million telephone calls to the IRS each year and have done so in every year since FY 2008.[3]
- Taxpayers make more than five million visits to the IRS's walk-in sites (known as Taxpayer Assistance Centers, or TACs) each year.[4]
- Taxpayers send an average of about ten million pieces of correspondence to the IRS in response to proposed adjustment notices each year to which the IRS must respond.[5]

The Concept of Operations (CONOPS) have the potential to bring about a fundamental transformation in the way our government treats its taxpayers and interacts with them. The CONOPS and associated documents speak of contemplated changes in very positive tones. They say little about reductions in core taxpayer services. They say nothing about the increased taxpayer costs and security risks created by relying more on tax return preparers and other third parties for assistance and interacting with the IRS.

Many of the telephone and walk-in contacts take place as taxpayers are trying to prepare their tax returns. But a large number of contacts take place in the post-filing environment, where the IRS has proposed to adjust a taxpayer's tax liability or the IRS has delayed issuing the taxpayer's refund. While some pre-filing contacts may require only generic answers, post-filing contacts are almost always account-specific and require IRS employees to study the details of the taxpayer's account to respond.

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 a great deal of additional taxpayer frustration with the IRS. As a result, confidence in the fairness of the tax system will erode, and taxpayer frustration and alienation may lead over time to a lower rate of voluntary compliance.

In the National Taxpayer Advocate's mid-year report to Congress, we recommended that the IRS make the CONOPS available for public review and comment.[6] To date, the IRS has not provided comprehensive information about its future state plans to the public, and it has not solicited public comment.

3 See IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total* (final week of each fiscal year for FY 2008 through FY 2015).

4 IRS Wage & Investment Division, Business Performance Review 7 (4th Quarter – FY 2015, Nov. 2, 2015); Government Accountability Office (GAO), GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks* 21 (Dec. 2014) (showing the number of TAC visits in each year from FY 2009 through FY 2014). During the 2015 filing season, the IRS maintained 380 TACs. See Treasury Inspector General for Tax Administration, Ref. No. 2016-IE-R001, *Selected Taxpayer Assistance Centers Were Professional and Organized, and Sensitive Information and Equipment Were Properly Secured* 1 (Oct. 2015).

5 Over the past decade, annual taxpayer correspondence in response to proposed adjustments has ranged from a low of 7.9 million letters to a high of 11.8 million letters and has averaged just over ten million per year. See IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2006 through FY 2015).

6 National Taxpayer Advocate FY 2016 Objectives Report to Congress 7.

The National Taxpayer Advocate is designating the future of taxpayer service as the #1 most serious problem for taxpayers for purposes of this year's report because the CONOPS have the potential to bring about a fundamental transformation in the way our government treats its taxpayers and interacts with them. The CONOPS and associated documents speak of contemplated changes in very positive tones. They say little about reductions in core taxpayer services. They say nothing about the increased taxpayer costs and security risks created by relying more on tax return preparers and other third parties for assistance and interacting with the IRS.

But trade-offs are inevitable if new services are to be developed and rolled out in a tight budgetary environment. Therefore, we believe it is critical that the IRS share its plans in detail with Congress and outside stakeholders and then engage in a dialogue about the extent to which it intends to curtail or eliminate various categories of telephone service and face-to-face service, whether it will provide sufficient support for taxpayers — and how — as it transitions to its future state, and whether it has an adequate "Plan B" if taxpayer demand for telephone and face-to-face service remains higher than the IRS anticipates. We also believe the IRS should estimate the additional financial burden its plan will impose on various categories of taxpayers — including elderly, low income, disabled, and limited English proficiency taxpayers and small businesses — as well as the impact its plan is likely to have on voluntary compliance.

These concerns are detailed below. In addition, the National Taxpayer Advocate provides a broader assessment of the IRS's future state planning in her preface to this report.

ANALYSIS OF PROBLEM

Long-term strategic planning is critical to the success of any organization, particularly one as large and complex as the IRS. In recent years, significant reductions to the agency's funding level have forced it to scale back its activities in almost every area and to rethink its priorities.[7]

Beginning in 2014, each of the IRS's four IRS Business Operating Divisions developed a CONOPS to articulate its vision and strategic approach for the following five-year period. Later, some of the other IRS functions developed a CONOPS, and the discrete CONOPS documents developed by the business units were ultimately consolidated into a single, enterprise-wide CONOPS.[8]

The IRS senior leadership team and IRS personnel in every business unit have devoted substantial time to this effort. The IRS also has entered into contracts with management consultants, costing the agency several million dollars, for support.

The CONOPS encompass both taxpayer service and enforcement activities, and they describe many initiatives that will both benefit taxpayers and make IRS operations more efficient. Because the IRS has chosen not to release the CONOPS, we are limited in our ability to provide much detail. However, the

7 Since FY 2010, the IRS budget has been reduced by about 19 percent in inflation-adjusted terms. In FY 2010, the agency's appropriated budget stood at $12.1 billion. For FY 2016, its budget has been set at $11.2 billion, a reduction of nearly 8 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* (230-31), Table 10.1, *available at* https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/hist.pdf (showing Gross Domestic Product (GDP) and year-to-year increases in the GDP). In addition, the IRS has had to implement the statutory requirements of the Patient Protection and Affordable Care Act and the Foreign Account Tax Compliance Act during this time, causing a further drain on its resources.

8 The four IRS Business Operating Divisions are the Wage & Investment Division, the Small Business/Self-Employed Division, the Tax Exempt & Government Entities Division, and the Large Business & International Division. Other functions that developed CONOPS include the Office of Appeals and the Criminal Investigation function.

IRS Chief Counsel recently articulated the following seven themes for the IRS's future state in a written document distributed at a public event:

- Facilitate voluntary compliance by empowering taxpayers with secure innovative tools and support.
- Understand non-compliant taxpayer behavior and develop approaches to deter and change it.
- Leverage and collaborate with external stakeholders.
- Cultivate a well-equipped, diverse, skilled, and flexible workforce.
- Select highest value work using data analytics and robust feedback loops.
- Drive more agility, efficiency, and effectiveness in IRS operations.
- Strengthen cyber defense and prevent identity theft and refund fraud.[9]

These are laudable goals, but they are very general. As always, the devil is in the details, and unless and until the IRS releases the CONOPS, neither the public nor Congress will have access to the details.

In the National Taxpayer Advocate's mid-year report to Congress, we recommended that the IRS make the Concept of Operations available for public review and comment. To date, the IRS has not provided comprehensive information about its future state plans to the public, and it has not solicited public comment.

Online Taxpayer Accounts Are Unlikely to Produce a Substantial Reduction in Taxpayers' Needs for Telephone and Face-to-Face Assistance

One specific initiative that IRS officials have described publicly is the creation of online taxpayer accounts through which taxpayers can interact with the agency.[10] We have recommended in the past that the IRS develop this capability,[11] provided the agency can work through security risks.[12]

Of considerable concern, however, is what is *not* stated in the CONOPS. Nowhere in the CONOPS is there a statement that the IRS plans to reduce telephone service or close walk-in sites, even though that is a central component of its strategy. By proposing to add new services and continuing to note the impact of funding constraints, it is implicit that some existing services will be reduced or eliminated.

9 William J. Wilkins, Chief Counsel, Internal Revenue Service, *Tax Enforcement in a Resource-Challenged World* 7 (written outline distributed in conjunction with address before the 32nd Annual National Institute on Criminal Tax Fraud and the Fifth National Institute on Tax Controversy, Dec. 11, 2015, Las Vegas, Nevada).

10 Luca Gattoni-Celli, *IRS to Roll Out Online Taxpayer Accounts*, 2015 TNT 213-3, Tax Notes Today (Nov. 4, 2015) (quoting Karen Schiller, Commissioner of the IRS's Small Business/Self-Employed Division, as saying: "Our future vision is, interacting with the IRS will be similar to how the interaction is with a financial institution or a bank … more online access, more self-service capability"). *See also* Matthew R. Madara, *IRS to Expand Online Access As Agency Looks to the Future*, 2015 TNT 240-2, Tax Notes Today (Dec. 14, 2015) (reporting on remarks of William J. Wilkins, Chief Counsel, Internal Revenue Service).

11 *See* National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers In Return Preparation and Decrease Improper Payments*); National Taxpayer Advocate 2012 Annual Report to Congress 251-61 (Most Serious Problem: *The IRS Is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to Be Done*) and 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical As the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

12 The "Get Transcript" problems involving unauthorized access to taxpayer account information that came to light during 2015 have caused widespread concerns. For more details about those problems, see IRS, *IRS Statement on the "Get Transcript" Application* (May 26, 2015), *available at* https://www.irs.gov/uac/Newsroom/IRS-Statement-on-the-Get-Transcript-Application. The IRS must redouble its efforts to ensure it takes all appropriate steps to guarantee data security and reassure the public it has done so before it rolls out online accounts.

The key unanswered question is by how much. In general, IRS leaders are only indirectly alluding to the possibility of service reductions. In a recent all-employee email, the Commissioner wrote about offering "more online and self-service options to build on our in-person options … [f]or those taxpayers with the ability and interest."[13] An accompanying summary stated that "[t]his approach also has a goal of freeing up limited IRS in-person resources — such as our phone lines — to more easily serve people and tax professionals who need one-on-one assistance."[14]

However, the widespread expectation is that traditional taxpayer services – telephone assistance and face-to-face assistance — will be scaled back dramatically. Based on our internal discussions with IRS officials, TAS has been left with the distinct impression that the IRS's ultimate goal is 'to get out of the business of talking with taxpayers.'

There is an enormous difference between developing online accounts with the hope that they will reduce taxpayer demand for personal service, on the one hand, and making plans to reduce personal service now. It is incumbent upon the IRS to be much more specific about how much personal taxpayer assistance it expects to provide in its "future state."

There are three reasons why we are not optimistic online accounts will dramatically reduce taxpayer demand for telephone or face-to-face service:

1. **Millions of taxpayers do not use the Internet.** A Pew Research Center study published in 2015 found the percentage of American adults who do not use the Internet is about 16 percent.[15]
2. **Millions of taxpayers who use the Internet do not want to handle complex financial transactions online.** According to a Forrester Research study published in 2015, 37 percent of survey respondents said they do not trust the federal government to secure their personal data, and the majority uses non-digital channels more than digital ones.[16] Moreover, a 2014 TAS study of taxpayers with incomes of less than 250 percent of the federal poverty level ($29,175 for a single person in the 48 contiguous states, D.C., or Puerto Rico) found that more than 70 percent of these taxpayers preferred communicating in person, and only about ten percent were willing to interact by computer.[17]

   Example: Assume a taxpayer has been victimized by identity theft or has been asked to supply identity information after IRS filters have flagged his return and frozen his refund pending verification. Many taxpayers whose personal information has been actually or potentially compromised will not feel comfortable entering the very same personal information into an Internet site. Moreover, many taxpayers waiting for a much-needed refund will want to resolve the problem directly with an IRS employee so they know, when the call ends, whether the documentation they are providing is sufficient and when they can expect to receive their refund.

13 Email from John A. Koskinen, Commissioner of IRS, to all employees, *Update on IRS changes, Future State work* (Dec. 16, 2015).

14 Summary explanation titled "A future vision for taxpayers and employees." *Id.*

15 Andrew Perrin & Maeve Duggan, Pew Research Center, *American's Internet Access: 2000-2015* (June 26, 2015).

16 Rick Parrish, Forrester Research, *Washington Must Work Harder to Spur the Public's Interest in Digital Government: Federal Agencies Are Spending Millions on Digital CX That Customers May Not Want* (Apr. 28, 2015).

17 *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2 § 1, 9 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help From the Clinics*). About 45 percent of taxpayers have incomes at or below 250 percent of the Federal Poverty Level. IRS CDW, Individual Returns Transaction File, tax year 2014

3. **Even among taxpayers who have Internet access and skills and are comfortable handling financial transactions online, the complexity of tax issues and the amount of money at stake will make online resolution impractical or undesirable from the taxpayer's perspective in many cases.** Online resolution will be difficult partly due to the complexity of the transaction and partly due to the difficulty in designing a website that is both easily navigable by first-time users and capable of handling a wide range of transactions. Online accounts work well for "cookie cutter" transactions. For example, a bank website can be easy to use if the account holder is solely seeking to pay bills; an airline website can be easy to use if a passenger is solely seeking to purchase tickets; and a retailer's website can be easy to use if a customer is seeking solely to make a purchase. But if the account holder wishes to dispute an erroneous charge, the passenger is seeking a refund, or the purchaser of retail goods has not received his order by the promised date, a telephone call is often necessary. When dealing with the IRS, little is "cookie cutter" and much is case-specific.

   Example: A taxpayer may claim the earned income tax credit with respect to a child only if the child lives with her for more than one-half of the year.[18] Where parents have been divorced or otherwise live separately and the child lives part-time with each parent, it can be difficult for the parent claiming the credit to substantiate that the child lived with her for more than one-half of the year. An online account cannot substitute for a conversation with an IRS employee in which the parent describes the kinds of records she possesses and can talk through which ones the IRS will accept.

   Example: The IRS denies business deductions claimed by a small business, such as a sole proprietor. Businesses keep expense records in different formats, and it is often not clear to a small business owner what documentation the IRS will accept. Rather than uploading large volumes of records through an online account, the business owner may wish to speak with an IRS employee to clarify the documentation requirements.

In light of the complexity of the tax code and the wide variation in taxpayer circumstances, these are typical problems that arise. Where substantial money is at stake and particularly where a taxpayer is experiencing a financial hardship, an online account will neither resolve issues like these nor provide the taxpayer with the certainty he seeks.

Pre-Filing Requests for Assistance. In 2015, the IRS received about 150 million income tax returns from individuals.[19] It also received more than ten million returns from business entities (corporations and partnerships).[20] Many of these taxpayers seek assistance from the IRS in the course of preparing or filing their returns. Requests for assistance range from the general (*e.g.,* a request for a form or a tax-law

18 *See* IRC § 32(c)(3)(A) (incorporating the definition of a qualifying child in IRC § 152(c)(1)(B)).

19 In calendar year 2015, the IRS received slightly more than 150 million individual income tax returns. *See* IRS, *Filing Season Statistics for Week Ending Nov. 20, 2015*, *available at* https://www.irs.gov/uac/Newsroom/Filing-Season-Statistics-for-Week-Ending-November-20-2015. For fiscal year 2015, the IRS projected it would receive just under 150 million returns but has not released the final count. *See* IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2015-2022,* Table 1 (Rev. Aug. 2015).

20 *See* IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2015-2022*, Table 1 (Rev. Aug. 2015). (projecting the IRS would receive about 6.9 million corporation income tax returns and 3.8 million partnership returns in FY 2015, a slight increase in both categories as compared with FY 2014).

Offloading work to third parties will substantially increase compliance costs for many taxpayers who now work directly with the IRS. Taxpayers deserve better. Having written a tax code so widely and rightly criticized for its complexity, the government has a practical and moral obligation to help taxpayers comply. It should not withdraw existing taxpayer service to the point where taxpayers have to incur additional compliance costs just to file their returns and pay their taxes.

question) to account-specific matters (*e.g.,* a request for a replacement Identity Protection (IP) PIN where a taxpayer has lost the IP PIN the IRS sent him by letter and cannot file his return without it).[21]

Post-Filing Contacts. In FY 2015, the IRS had actual or possible post-filing contacts with more than nine million taxpayers. Most arose because of proposed tax adjustments the IRS made. Others arose because the IRS temporarily or indefinitely froze tax returns and withheld refunds, generating taxpayer inquiries and attempts to provide substantiation.

If one were to focus solely on the individual audit rate of less than one percent,[22] one might assume that fewer than 1.5 million individual taxpayers have contacts with the IRS after filing a tax return. In fact, the number of taxpayers who have post-filing contacts with the IRS is vastly larger. For example:

- The IRS makes adjustments to taxpayer accounts under "math error" authority that do not count as audits.[23]
- The IRS makes adjustments to taxpayer accounts based on document-matching between information a taxpayer reports on his tax return and information the taxpayer's employer reports on a Form W-2 or a payor reports on a Form 1099. These adjustments also do not count as audits.[24]
- The IRS operates an Automated Substitute for Return program in which it creates tax returns for taxpayers who did not file and who the IRS believes should have filed a return.[25]

21 An IP PIN is a number assigned to an eligible taxpayer to help prevent the misuse of his Social Security number on fraudulent federal income tax returns. Once the IRS issues an IP PIN to a taxpayer, the taxpayer currently is required to use an IP PIN to file returns for the rest of his life. According to the IRS website: "You currently can't opt out once you get an IP PIN. You must use an IP PIN to confirm your identity on all federal tax returns you file this year and in subsequent tax years. If you e-file your return and your IP PIN is missing or incorrect, our system will reject your return. Filing a paper return with a missing or incorrect IP PIN delays its processing."

22 In FY 2014, the individual audit rate was 0.86 percent. *See* IRS, *FY 2014 Enforcement and Service Results* 2, *available at* https://www.irs.gov/PUP/newsroom/FY-2014%20Enforcement%20and%20Service%20Results%20–%20web%20version.pdf. At this writing, the individual audit rate for FY 2015 has not yet been released.

23 IRC § 6213(b) & (g).

24 *See* IRC § 7605 and Rev. Proc. 2005-32, 2005-1 C.B. 1206, regarding contacts with taxpayers and other actions taken by the IRS that are not treated as "examinations." In general, an examination involves the IRS's inspection of a taxpayer's books and records. Among contacts not treated as examinations are those resulting from the matching of information on a tax return with information already in the IRS's possession and considering any records the taxpayer provides voluntarily to explain a discrepancy between a filed return and information furnished by third parties that is used as part of a data-matching program. *See* § 4.03(1)(b) & (c) of Rev. Proc. 2005-32.

25 *See* IRC § 6020. For additional information regarding the automated substitute for return program, see Most Serious Problem: *Automated Substitute for Return (ASFR) Program: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*, *infra*.

- The IRS employs a wide variety of anti-fraud filters to screen out fraudulent tax returns and refund claims. However, these filters are inherently both under-inclusive and over-inclusive. Where filters are over-inclusive, the IRS sometimes notifies taxpayers it has frozen their returns and requires them to submit additional documentation before it can proceed, and it sometimes temporarily suspends the processing of their returns (and the issuance of refunds) pending internal verification measures. Even where the IRS is solely performing internal verification, taxpayers experiencing refund delays will often call the IRS to find out why.

Thus, the number of taxpayers who receive notices and may have to get into a dialogue with the IRS about their unique facts and circumstances is as follows:

FIGURE 1.1.1, Post-Filing Notices and Refund Delays That Generate Taxpayer Contacts[26]

Individual Audits	1,228,693
Document Matching (AUR) Notices	3,836,216
Math Error Notices	1,886,216
Automated Substitute for Returns	184,776
Refund Delays	2,078,311
Total	**9,214,212**

It is not realistic to expect that taxpayers who are told they owe more tax or whose refunds have been significantly delayed are going to be satisfied resolving their problems with the IRS exclusively through an online account. A high percentage of taxpayers in this situation will want to speak with an IRS employee so they can be certain they understand the source of the problem and what more they need to do — and try to obtain reassurance about when they can expect a final resolution.

IRS Technology Advancements Historically Have Not Reduced Taxpayer Demand for Personal Services Despite Hopes to the Contrary

Ever since Congress enacted the IRS Restructuring and Reform Act of 1998,[27] the IRS has been speaking about harnessing technology to improve efficiency and reduce the need for personal service. In fact, the IRS has succeeded in dramatically increasing the percentage of taxpayers who file their returns electronically, it has vastly expanded and improved its website to provide more information to taxpayers, and it

26 Sources for data on audit and similar contacts are as follows: IRS Audit Information Management System, Closed Case Database (showing number of individual examinations closed in FY 2015); IRS Compliance Data Warehouse, Notice Delivery System (showing number of CP2000 and CP2501 document-matching notices mailed to distinct taxpayers by the IRS's Automated Underreporter Program in FY 2015); IRS Individual Master File (showing number of math error notices mailed to distinct taxpayers in FY 2015); IRS Collection Activity Report NO-5000-139 (Oct. 5, 2015) (showing number of automated substitute for return (ASFR) notices issued in FY 2015; ASFRs are created with respect to taxpayers that did not file tax returns but that the IRS believes should have filed tax returns). Sources for data on refund delays are as follows: IRS Generalized Unpostable Framework (GUF) Report, GUF5740 Closed Inventory Summary (Dec. 17, 2015) (showing that 729,487 returns were initially deemed unpostable for inconsistency with ID theft business rules but were later processed in calendar year 2015 through Dec. 17); IRS Return Integrity & Compliance Services (RICS), *Update of the Taxpayer Protection Program (TPP)* 8, (Dec. 9, 2015) (showing that 649,915 returns were stopped by Taxpayer Protection Program filters but were later found to be legitimate in calendar year 2015 through Dec. 9); IRS Individual Master File (showing that 179,459 returns were stopped due to suspected fraudulent income documents that later were found to be legitimate and 155,103 returns were frozen from Jan. 1 through Sept. 30, 2015 because an identity theft return in the taxpayer's name had previously been submitted and posted; refund delays of less than two weeks are generally excluded from these totals). The number of refund delays shown in this figure is under-inclusive overall because there are additional sources of refund delays. However, a small number of returns may fit into more than one category and therefore be double-counted.

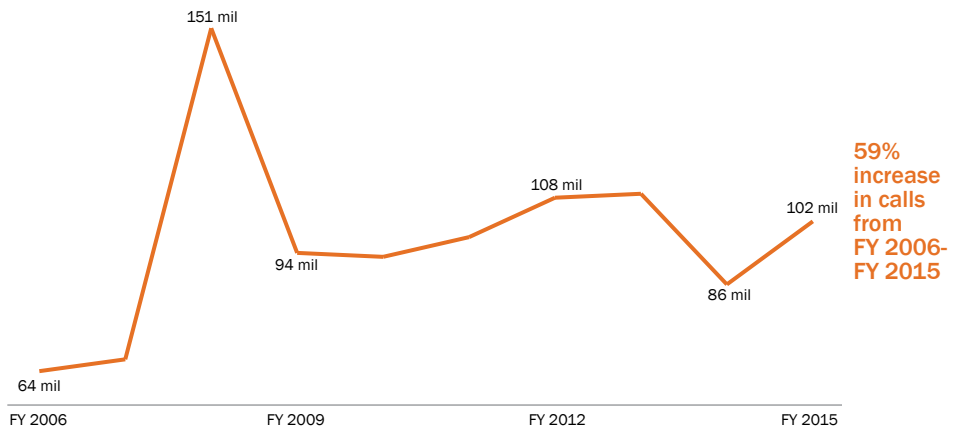
27 Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998).

has launched "Where's My Refund" to reduce telephone calls. The hope and expectation was that these measures would have substantially reduced taxpayer demand for personal service by phone or in person.

In fact, taxpayer demand for personal service has *increased* over time. The number of calls the IRS received on its Accounts Management lines over the past decade has risen from about 64 million in FY 2006 to about 102 million in FY 2015, an increase of about 59 percent, as shown in the following figure:

FIGURE 1.1.2[28]

Taxpayer Calls to IRS Accounts Management Telephone Lines



(The one-time spike in telephone calls in FY 2008 was attributable to widespread confusion concerning payments under the Economic Stimulus Act of 2008.)[29]

Taxpayer demand for face-to-face service at the IRS's walk-in sites has also remained high — above 5.6 million visits in FY 2015 — despite IRS service reductions, such as directing employees to refrain from answering tax-law questions and discontinuing the preparation of tax returns.[30]

These results are hardly surprising. The continuing demand for personal service despite greater online functionality is not unique to tax administration. For example, the Board of Governors of the Federal Reserve System conducts an annual survey of bank customers who use mobile phones to conduct their banking. The most recent survey found that 72 percent of bank customers reported they had visited a branch and spoken with a teller within the preceding month (an average of two times), and 68 percent reported they had used telephone banking within the preceding month (also an average of two times).

28 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2006 through FY 2015). The majority of the additional calls were handled by automation. The increase in calls seeking to speak with an IRS customer service representative (CSR) was 20 percent. The IRS's Snapshot Reports do not specify the number of calls routed to CSRs, but that number can be roughly computed by dividing the number of calls answered by CSRs by the percentage of calls answered by CSRs (known as the "CSR Level of Service"). The number of calls routed to CSRs on the Account Management telephone lines increased from about 39.8 million in FY 2006 to about 47.9 million in FY 2015. The percentage increase in calls seeking to reach a CSR likely would have been considerably higher absent IRS policies designed to limit the scope of CSR-eligible subjects, such as sharply restricting the scope of tax-law questions CSRs may answer.

29 Pub. L. No. 110-185, 122 Stat. 613 (2008).

30 IRS Wage & Investment Division, Business Performance Review 7 (4th Quarter – FY 2015, Nov. 2, 2015).

In addition, 85 percent reported they had used an automated teller machine (ATM) within the preceding month (an average of three times).

Summarizing these survey results, the report concluded:

> Taken together, these estimates indicate that while mobile banking users are utilizing technological platforms at a high rate and on a consistent basis, they have also maintained connections to their banks through the more traditional branch and ATM channels.[31]

There is no doubt that secure online taxpayer accounts will be a positive development for both taxpayers and the IRS. But the IRS's own experience with technology improvements and data from other sectors suggest online accounts are unlikely to substantially meet taxpayer demand for telephone and face-to-face service. Therefore, the open question is whether, and to what extent, online accounts will allow the IRS to achieve costs savings without leaving taxpayer needs unmet.

Requiring Taxpayers to Rely More on Tax Return Preparers and Other Third Parties Will Increase Taxpayer Costs and Create Data Security Risks

The CONOPS highlight a second concern. The IRS recognizes that not all taxpayers will be able to resolve problems through online accounts. To address the needs of these taxpayers, the IRS envisions giving tax practitioners, noncredentialed preparers, and tax software companies access to additional taxpayer information so they can assist taxpayers without the need for direct IRS involvement. That may work in some instances, but we have two reservations about this approach.

1. Offloading work to third parties will substantially increase compliance costs for many taxpayers who now work directly with the IRS. Taxpayers deserve better. Having written a tax code so widely and rightly criticized for its complexity, the government has a practical and moral obligation to help taxpayers comply. It should not withdraw existing taxpayer service to the point where taxpayers have to incur additional compliance costs just to file their returns and pay their taxes.
2. Tax return preparers are currently unregulated. Anyone, including individuals with no tax background and even individuals with criminal convictions, can obtain a Preparer Tax Identification Number from the IRS and hang out a shingle as a tax return preparer. Many are competent and conscientious, but as Government Accountability Office (GAO) and Treasury Inspector General for Tax Administration (TIGTA) studies have shown, others are not.[32] The IRS should not even consider giving tax return preparers access to taxpayer account information until it is able to establish minimum standards for competence, to suspend preparers who engage in improper conduct, and to conduct background checks to weed out preparers with criminal records. To grant all preparers access to taxpayer accounts is to put taxpayers' confidential tax information at risk.

Referring taxpayers to third party providers raises important issues — both policy issues regarding the role government should play in assisting taxpayers who are trying to comply with their tax obligations and practical issues regarding data security. These issues deserve a thorough public discussion before the IRS begins to downsize its existing taxpayer service operations and outsource taxpayer assistance to third

31 Board of Governors of the Federal Reserve System, *Consumers and Mobile Financial Services 2015*, at 11 (Mar. 2015), *available at* http://www.federalreserve.gov/econresdata/consumers-and-mobile-financial-services-report-201503.pdf.

32 *See* GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* (Apr. 2014); TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 2008); GAO, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (Apr. 2006).

parties, which will have the effect of introducing a third-party intermediary between the IRS and taxpayers, and increasing taxpayers' compliance costs.

CONCLUSION

The IRS's future state plan has been driven by two considerations. First, long-range strategic planning is always important to ensure an organization achieves its objectives as effectively and efficiently as possible. Second, significant reductions in the IRS's budget since FY 2010 have forced the agency to look for ways to scale back its operations in order to deliver on its tax-collection mission more cheaply.

The National Taxpayer Advocate has been recommending against significant reductions in the IRS's budget because reductions of this magnitude have harmed taxpayers. Moreover, while this report identifies numerous areas where we believe the IRS can and should improve, it is important to acknowledge that the IRS generally speaking is an efficient agency. In FY 2015, the IRS collected about $3.3 trillion on a budget of $10.945 billion, which translates to a return-on-investment of about 300:1.[33]

There is much in the CONOPS that is positive for taxpayers and the IRS. However, the implicit intent to make substantial reductions in telephone and face-to-face taxpayer service — particularly when coupled with the implicit intent to refer more taxpayers to for-profit practitioners and preparers for help that the IRS currently provides — raises concerns about whether the government will continue to meet its responsibilities to taxpayers.

Because the CONOPS lay out proposals that will be transformational for taxpayer service, we believe the IRS should publish its proposed plans and seek public comments and suggestions before it adopts any proposals and before, even if it has not formally adopted them, any of these proposals becomes a *fait accompli*. U.S. taxpayers pay the bills for our government. U.S. taxpayers deserve a say in how the tax collection agency will treat them.

RECOMMENDATIONS

1. The National Taxpayer Advocate recommends that the IRS immediately publish its CONOPS, publicize them widely, and seek comments and suggestions from the public.
2. The National Taxpayer Advocate recommends that Congress hold hearings during the next few months on the future state of IRS operations. These hearings will help foster better communication between the IRS and Congress on the front-end, potentially reducing the risk of continuing conflict in the future. 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 CONOPS will impose on various categories of taxpayers as well as the likely impact of the CONOPS on the overall rate of voluntary tax compliance.

33 GAO, GAO-16-146, 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 (showing the IRS collected total tax revenue of about $3.3 trillion in FY 2015); IRS, *IRS FY 2016 Budget-in-Brief*, *available at* https://www.irs.gov/PUP/newsroom/IRS%20Budget%20in%20Brief%20FY%202016.pdf (showing the IRS's enacted FY 2015 IRS appropriation was $10,945,000,000).

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

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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Quality Service*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Between fiscal years (FY) 2010 and 2015, the IRS's appropriation declined by about ten percent (from $12.15 billion to $10.95 billion), and its user fee revenue increased by about 34 percent (from $290 million to $391 million).[2] The IRS is actively considering user fee increases that would mitigate cuts to its appropriation.[3] The IRS's need for user fee revenue heightens the importance of requiring employees to:

- Avoid fees that impair its service-oriented mission, voluntary compliance, or taxpayer rights;
- Estimate the effect of the fee on demand for service; and
- Publish its user fee analysis and address any comments from internal and external stakeholders before adopting or increasing a fee.

Even 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. They may seem even more outrageous

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Treasury Department, *Congressional Justification* (FY 2010-2016), *available at* http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx; IRS response to TAS information request (May 20, 2015); IRS response to TAS information request (Oct. 22, 2015).

3 IRS response to TAS information request (Oct. 22, 2015). For a discussion of the effect of these cuts, see, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 20-39 (Most Serious Problem: *The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

The IRS is not a business selling rights only to those willing to pay.

when combined with the IRS's plans to reduce services it previously provided for free, shifting more tax compliance burdens to taxpayers.[4]

Shifting compliance burdens to taxpayers is inconsistent with the IRS mission and taxpayer rights, and may reduce voluntary tax compliance. The IRS's mission is to "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the tax law with integrity and fairness to all."[5] User fees discourage taxpayers from obtaining services that could help them "understand and meet their responsibilities."

User fees may also erode taxpayer rights, such as the *right to quality service*. This "right" to quality service may be inconsistent with requiring taxpayers to pay a fee for it. The IRS is not a business selling rights only to those willing to pay. If some are able to pay and others are not, then the fee may also erode the *right to a fair and just tax system*.

In addition, IRS services often promote voluntary compliance.[6] Thus, if a fee discourages taxpayers from using services, it may erode tax compliance, particularly if it combines with other burdens to make them lose interest in trying to comply.

ANALYSIS OF PROBLEM

The IRS Has Discretion in Setting User Fees

The Independent Offices Appropriation Act of 1952 (IOAA) generally requires federal agencies to establish user fees at "full cost" for services that convey "special benefits."[7] However, fees must be "fair" and based, in part, on the "public policy or interest served," and agencies can seek a waiver of this requirement from the Office of Management and Budget (OMB).[8] Various other laws give the IRS discretion to set a "reasonable" fee for specific items.[9] Thus, the IRS does not have to impose user fees that have undesirable consequences.

The IRS Seems to Prioritize User Fee Revenue

It took the IRS the 43 years between 1952 and 1995 to charge any fees based on the IOAA. In 1995, after Congress allowed it to retain some of its user fee revenue,[10] the IRS imposed a new $43 user fee to

4 *See, e.g.*, Most Serious Problem: *Taxpayer Access to Online Accounts: 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.*

5 Internal Revenue Manual (IRM) 1.1.1.2, *IRS Mission* (June 2, 2015).

6 See, *e.g.*, Dept. of Treasury, *Reducing the Federal Tax Gap a Report on Improving Voluntary Compliance* (Aug. 2, 2007), *available at* http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf.

7 31 U.S.C. § 9701.

8 *Id.*; OMB, Circular A-25, 58 Fed. Reg. 38,142 (July 15, 1993) (hereinafter "Circular A-25") (directing that an agency may apply for a user fee exception based on anything that "in the opinion of the agency head or his designee, justifies an exception.").

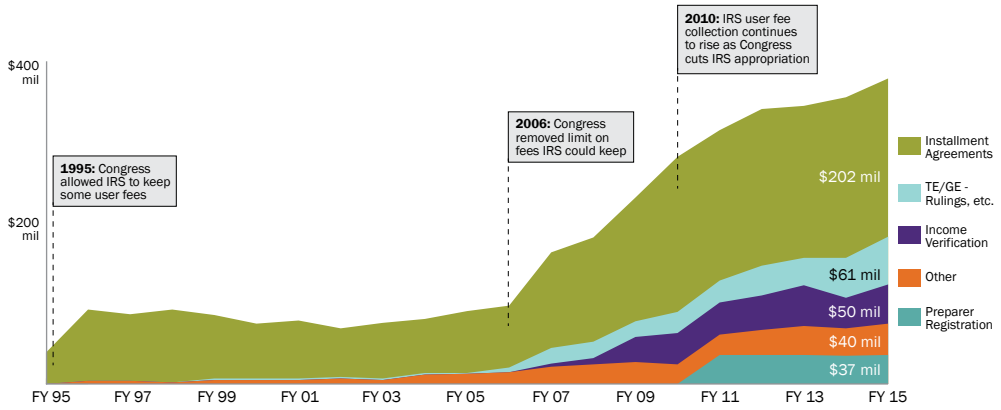
9 *See, e.g.*, Internal Revenue Code (IRC) § 6103(P) (reproduction of returns and the disclosure of return information, such as a U.S. Residency Certification, Income Verification Express Service (IVES), and copies); IRC § 7528 (letter rulings, opinion letters, determination letters, art valuation, and similar requests); IRC § 6104 (copying and mailing exempt organization (EO) materials and returns); IRC § 6108 (statistical studies); 5 U.S.C. § 552(a)(4)(A) (FOIA document search, duplication, and review); IRC § 6110(k) (reproduction of Chief Counsel Advice); 29 U.S.C. 1202a (Employee Plan Compliance Resolution System); IRM 1.32.19.21, *Types of User Fees* (Nov. 8, 2012). The IRS must also collect a $500 user fee from any person claiming a deduction for a historical preservation easement. *See* IRC § 170.

10 31 U.S.C. § 3302(b) (requiring user fees to be deposited with the Treasury, absent specific statutory authority); Treasury Postal Service and General Government Appropriations Act of 1995, Pub. L. No. 103-329, § 3, 108 Stat. 2,382 (1994) (codified at IRC § 7801 (note)) (allowing the IRS to retain certain user fee receipts).

enter into an installment agreement (IA).[11] In 2006, Congress removed the limit on the amount of fee revenue the IRS could keep.[12] User fee receipts immediately increased, and the IRS has acknowledged that with the reductions in enacted appropriations beginning in FY 2011, it has increasingly relied on user fees for funding, as shown in Figure 1.2.1.[13]

FIGURE 1.2.1

IRS User Fee Revenue



Between FYs 2010 and 2015, the IRS's appropriation declined by about ten percent (from $12.15 billion to $10.95 billion), and its user fee revenue increased by about 34 percent (from $290 million to $391 million).[14] Although user fees were historically used, in large part, to fund services, beginning in FY 2015, the IRS shifted user fee revenue expenditures from taxpayer service to operations support, primarily information technology infrastructure to implement the Affordable Care Act (ACA).[15] User fees applied to service expenditures declined by 75.4 percent (from $183 million in FY 2014 to $45 million in FY 2015), while user fees applied to operations support expenditures increased by 77.0 percent (from $222 million in FY 2014 to $393 million in FY 2015), and the IRS plans to allocate more user fee revenue to operations support than to services in FY 2016, as shown in Figure 1.2.2.[16]

Between FYs 2010 and 2015, the IRS's appropriation declined by about ten percent (from $12.15 billion to $10.95 billion), and its user fee revenue increased by about 34 percent (from $290 million to $391 million).

11 T.D. 8589, 60 Fed. Reg. 8298 (Feb. 14, 1995); Treas. Reg. § 300.0-300.2.

12 Pub. L. No. 109-115 § 209, 119 Stat. 2439 (2006) (codified at IRC § 7801 (note)). OMB Circular A-25 also requires agencies to update user fees every two years.

13 IRS response to TAS fact check (Nov. 13, 2015). Even though user fee revenue has been rising, the IRS has spent more of its user fee collections every year since FY 2010 (spending $481,882,027 in FY 2015 (planned), up from $148,124,769 in FY 2010), causing the carryover balance in its user fee account to decline from its high-water mark of $352,928,852 at the beginning of FY 2013 to $193,074,529 as of September 30, 2015. *Id*.

14 Treasury Department, *Congressional Justification* (FY 2010-2016), *available at* http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx; IRS response to TAS information request (May 20, 2015); IRS response to TAS information request (Oct. 22, 2015).

15 The House Ways and Means Committee expressed concern about this shift. House Ways and Means Committee, *Majority Staff Report, Doing Less with Less: IRS's Spending Decisions Harm Taxpayers*, 114th Cong. (Apr. 22, 2015).

16 IRS response to TAS information request (Oct. 22, 2015).

FIGURE 1.2.2, User Fee Spending by Account[17]

Account	FY 2013		FY 2014		FY 2015		FY 2016 (Plan)	
Taxpayer Services	$191 mil	48.3%	$183 mil	43.6%	$45 mil	9.7%	$97 mil	22.9%
Enforcement	$20 mil	5.2%	$15 mil	3.5%	$21 mil	4.5%	$10 mil	2.4%
Operations Support	$184 mil	46.6%	$222 mil	52.9%	$393 mil	85.8%	$316 mil	74.7%
Total	**$396 mil**		**$419 mil**		**$459 mil**		**$423 mil**	

The IRS's reliance on user fee revenue to offset cuts creates a conflict of interest. This conflict is stronger when the IRS appropriation declines. Agencies are supposed to reevaluate user fees every two years, but the IRS has asked its business units (BUs) to reevaluate them more often in the last few years due to its declining appropriation.[18]

User Fees Can Undermine the IRS Mission, Voluntary Compliance, and Taxpayer Rights

If fees discourage taxpayers from using IRS services, they may undermine the IRS mission, voluntary compliance, and taxpayer rights. For example, in addition to penalties and interest for late payments, the IRS charges taxpayers a fee to set up an IA, which it increased from $105 to $120 in 2014.[19] It is considering further increases to the IA fee.[20] If this fee discourages taxpayers who cannot pay in full from making arrangements to pay, then it:

1. Reduces voluntary compliance, potentially prompting the IRS to issue more wage levies or classify more accounts as uncollectible;
2. Is inconsistent with the IRS mission to help taxpayers "meet their tax responsibilities;"[21] and
3. Is inconsistent with the taxpayer's *right to privacy*, *i.e.*, that enforcement be "no more intrusive than necessary."[22] Paying in installments would be less intrusive than a levy. It may also be inconsistent with the *right to a fair and just tax system*, which requires the tax system to "consider facts and circumstances that might affect … ability to pay."[23] Similarly, it may be inconsistent with the idea that *quality service* is a fundamental taxpayer right, which should not be subject to a fee.[24]

17 IRS response to TAS fact check (Nov. 13, 2015). The FY 2016 projections are preliminary and subject to change. The IRS increased the user fees allocated to operations support, in large part, to implement the ACA. IRS response to TAS information request (Oct. 22, 2015).

18 Circular A-25 § 8(e) (two years). The IRS held its biennial user fee review process in 2007, 2009, 2011, 2013, and 2015, as well as an out-of-cycle review in 2014. IRS response to TAS information request (May 20, 2015). The IRS also sought revenue-raising ideas in connection with a resource realignment effort in early 2015.

19 T.D. 9647, 78 FR 72016 (2014); Treas. Reg. § 300.1 (IA fee).

20 IRS response to TAS information request (Oct. 22, 2015) (FY 2015 Biennial Review of User Fee Charges, Attachment 2).

21 IRM 1.1.1.2, *IRS Mission* (June 2, 2015).

22 IRS Pub 1, *Your Rights as a Taxpayer* (2014).

23 *Id*.

24 *Id*. *Cf.*, *Harper v. Virginia State Bd. of Elections*, 383 U.S. 663 (1966) (holding unconstitutional a state-imposed $1.50 poll tax) and *Bullock v. Carter*, 405 U.S. 134 (1972) (holding unconstitutional a state-imposed filing fee of between $1 and $8,900 to register as a candidate in the primary election, even as to fees that were limited to less than ten percent of the candidate's gross income). If an IA fee does not actually discourage any taxpayers from obtaining an IA, then it should not be imposed under existing criteria, because it is not really voluntary. *See*, *e.g.*, IRM 1.32.19.20, *Review and Implementation of New User Fees* (Nov. 8, 2012). Moreover, the National Taxpayer Advocate questions whether an IA or offer in compromise (OIC) is actually a "special" service, as some people will simply not be able to pay and the IRS will need to deal with them in some way.

As another example, the Private Letter Ruling (PLR) fee increased from $10,000 to $28,300 in 2015 for an exempt organization (EO) with gross income of $1 million or more.[25] If only some taxpayers who need guidance can afford a PLR, the PLR fee is inconsistent with the taxpayer *right to a fair and just tax system*, which includes the right to expect the tax system to "consider facts and circumstances that might affect their underlying liabilities."[26] Although lower PLR fees apply to those with lower gross income, when combined with the amount taxpayers have to pay to an advisor to help with a PLR submission, the PLR fee may discourage taxpayers from obtaining the information they need (*i.e.*, a PLR) to voluntarily comply. According to some practitioners, for the first time in history the $28,000 PLR filing fee may now exceed the legal costs of preparing the PLR request.[27]

The Internal Revenue Manual (IRM) Provides Limited Guidance About How to Evaluate User Fees

The IRM requires IRS employees to consider the following factors in setting user fees:

- The voluntary nature of the user fee activities. The IRS does not charge taxpayers for special services that they do not request.
- The benefit must be identifiable to a specific taxpayer.
- The cost of administering the user fee, as this cannot be a substantial amount of the fee.
- The impact of the user fee on low income taxpayers.[28]

The IRM does not require employees to consider the effect of user fees on the IRS's service-oriented mission, voluntary compliance, taxpayer burden, or taxpayer rights.[29] Nor does it require them to estimate the effect of fees on the demand for service or downstream costs so that they can make better informed decisions about these effects.[30]

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. They may seem even more outrageous when combined with the IRS plans to reduce services it historically provided for free, shifting even more

25 Previously, the fee for PLRs from Tax Exempt/Government Entities (TE/GE) was a flat $10,000 for all organizations. Rev. Proc. 2014-8, § 6.08, 2014-1 I.R.B. 242 (2014). In form, the 2015 fee for PLRs from IRS Counsel only increased from $19,000 to $28,300 for EOs with gross income of $1 million or more. Rev. Proc. 2015-1, App'x A(3), 2015-1 I.R.B. 1 (2015). However, due to an IRS realignment in 2014, EOs seeking PLRs now pay the rates applicable to IRS Counsel. Rev. Proc. 2015-8, § 6, 2015-1 I.R.B. 235 (2015). As a result, the fee effectively increased from $10,000 to $28,300. EOs with high gross income may have little net income with which to pay a fee. They may also divert funds to pay the user fee that would otherwise be used to provide important services to the public.

26 IRS Pub 1, *Your Rights as a Taxpayer* (2014). Although the fee is lower for those with lower gross income, there is no low income waiver for PLRs. *See, e.g.*, Rev. Proc. 2015-1, App'x A(3), 2015-1 I.R.B. 1 (2015).

27 Paul Streckfus, EO Tax Journal, *Email Update 2015–102* (May 27, 2015) (quoting comments by Rob Wexler at an American Bar Association Tax Section meeting).

28 IRM 1.32.19.20(1), *Review and Implementation of New User Fees* (Nov. 8, 2012). In 2007, the National Taxpayer Advocate reported the IRS did not have a consistent methodology for determining whether to charge a fee. National Taxpayer Advocate 2007 Annual Report to Congress 66-82. The IRS subsequently documented the process for setting fees.

29 As noted above, however, 31 U.S.C. § 9701 generally requires user fees to be "fair" and based, in part, on the "public policy or interest served," and OMB Circular A-25 provides that an agency may apply for a user fee exception based on anything that "in the opinion of the agency head or his designee, justifies an exception."

30 The IRS generally estimates the impact of fees on demand for services only after they are imposed or increased. TAS midpoint call with responsible officials (Sept. 17, 2015). It does not isolate the effect of the fee from other factors that may affect demand. *Id*.

of the burden of tax compliance to taxpayers.[31] In such cases, they may be even more likely to discourage taxpayers from using IRS services.

IRS Employees Sometimes Consider the Downstream Effects of Fees

In its biennial user fee reviews, the IRS sometimes considers the effect of a fee increase on service and compliance.[32] For example, in the FY 2011 Biennial Review the Small Business/Self-Employed Division (SB/SE) recommended retaining the existing IA fee, which was below full cost, because, among other things:

- Keeping the present rates encourages taxpayers to enter into an IA and pay down the current liability; and
- Increasing the rate may discourage taxpayers from using the IA process, age our accounts receivable and move us closer to the statute expiration date without resolution of the account.[33]

In the FY 2013 Biennial Review, the IRS's National Public Liaison (NPL) office — an office that facilitates communications between the IRS and external stakeholders — opposed a user fee for the Nationwide Tax Forums, in part, because there is "significant value in providing a national platform for education and outreach activities."[34] Similarly, the Large Business and International Division (LB&I) opposed a fee for the Compliance Assurance Process (CAP) because CAP encourages voluntary compliance and benefits the IRS.[35] It also opposed increasing the $50,000 fee for Pre-Filing Agreement (PFAs) to the IRS's full cost of $265,475.[36] LB&I reasoned that PFAs "enhance compliance," and as part of its mission to provide taxpayer service, it believes the PFA program helps to prepare taxpayers to become a part of CAP."[37]

Without express guidance that IRS employees should consider the effect of fees on service, the IRS mission, taxpayer rights and burden, and voluntary compliance, they may feel pressure to ignore these considerations.

In the 2011 review, the Tax Exempt and Government Entities Division (TE/GE) opposed charging full cost to issue a PLR to individuals who need guidance about Roth IRA recharacterizations.[38] It reasoned that the fee can be prohibitive for individuals and negatively affect retirement savings. In the 2009 review, it also recommended a less-than-full-cost fee for approving

31 *See, e.g.*, 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*.

32 IRS response to TAS information request (May 20, 2015) (attachments A and G).

33 *Id.* (attachment G). SB/SE used a similar justification to avoid increasing the fee for OICs in the FY 2011 Review. *Id.*

34 IRS response to TAS information request (May 20, 2015) (attachment A); IRM 1.1.11.4, *Office of National Public Liaison* (Feb. 12, 2015).

35 CAP is a program that allows large businesses under continuous audit to, in effect, have the IRS audit the return before it is filed, increasing voluntary compliance and reducing the burden of post-filing examinations for both the IRS and taxpayers. *See, e.g.*, IRM 4.51.8 (June 15, 2012).

36 IRS response to TAS information request (May 20, 2015) (attachment A).

37 Similarly, LB&I argued that Advanced Pricing Agreements (APAs) are deliberately set at 50 percent of their total cost because they help reduce enforcement costs while providing a benefit to taxpayers. IRS response to TAS information request (May 20, 2015) (attachment A). In the 2011 review, LB&I also "considered but rejected a user fee for Qualified Intermediaries because the IRS wants to encourage foreign intermediaries to become qualified intermediaries and a user fee would have a negative impact on this process." IRS response to TAS information request (May 20, 2015) (attachment G). As the Business Units (BU) proposed to increase the APA and PFA fees in 2015, LB&I either did not voice these concerns or they were minimized in the latest review. IRS response to TAS information request (Sept. 22, 2015) (Executive Summary).

38 IRS response to TAS information request (May 20, 2015) (attachment G).

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.

certain (master and prototype volume submitter) employee plans.[39] It reasoned that because these pre-approved plans are ultimately adopted by thousands of employers, they help TE/GE manage its workload by reducing requests for plan approvals.

In some cases the IRS also recommended that fees depart from its full-cost estimates when those estimates were in flux. The IRS's cost estimates depend on assumptions about what overhead costs should be included and how many taxpayers use the service (*e.g.*, when more taxpayers use a service, unit costs decline).[40] Taxpayers should not have to pay excessive user fees simply because there are not enough other taxpayers using a service to lower unit costs, particularly when demand for the service is in flux, or fixed or indirect costs seem excessive.[41] For example, if PLR unit costs increase because fewer taxpayers request them (*e.g.*, because the IRS has increased the fee), the IRS should not use its increased unit costs to justify increasing the fee even further. In such cases, employees should be required to recommend fees based on either the maximum demand expected for the service or on marginal costs, as they may have done in some cases.

Without Additional Guidance, the IRS May Not Consistently Evaluate User Fees, Resulting in Disparate Treatment of Taxpayers

Without express guidance that IRS employees should consider the effect of fees on service, the IRS mission, taxpayer rights and burden, and voluntary compliance, they may feel pressure to ignore these considerations.[42] Alternatively, they may ignore them in some cases and not others, resulting in disparate treatment of taxpayers. For example, the fees for CAP, which is used by the largest businesses may be below cost because LB&I employees raised concerns about voluntary compliance, whereas the fee for regular IAs may be at full cost because SB/SE employees did not.[43] The IRS may also begin to charge full costs for services, even when excessive overhead is included, a service is underutilized, or volume estimates are in flux. As noted above, the pressure to ignore or minimize these considerations is likely greater now that the IRS budget is constrained and it relies on user fees to replace its reduced appropriation.

39 IRS response to TAS information request (May 20, 2015).

40 "Full cost" fees can seem disproportionate to the value provided because they include direct and indirect costs such as "salaries and fringe benefits such as medical insurance and retirement.... Physical overhead, consulting ... material and supply costs, utilities, insurance, travel, and rents or imputed rents on land, buildings, and equipment." Circular 25-A, § d(1).

41 We understand the IRS's costs estimates spread start-up costs over a multi-year period. TAS midpoint call with responsible officials (Sept. 17, 2015). Nonetheless, the IRS's resulting full-cost estimates may still seem disproportionate and discourage taxpayers from utilizing a new or underutilized service.

42 Such considerations are consistent with OMB Circular A-4 (Sept. 17, 2003).

43 It is possible that SB/SE's concerns in this regard may not have been documented.

The IRS Does Not Fully Disclose What It Considers

When IRS employees analyze user fees, they do not fully disclose their analysis to the public (*e.g.*, the biennial review documents).[44] Discussing the rationale for and computation of proposed increases in public before they are adopted would ensure the IRS is better informed about the consequences. Stakeholders can provide relevant and helpful information about the impact of the fees on taxpayers and practitioners. The IRS should disclose everything it considers in connection with its user fee reviews and ask the public for comments before deciding to increase fees.

CONCLUSION

Rather than reactively applying user fees to fill a short-term funding deficit, the IRS should consider whether new and existing fees will discourage voluntary compliance, burden taxpayers excessively, or impair the IRS's service-oriented mission. If the IRS makes compliance too difficult or expensive, then compliance will decline. If a fee for service or a lack of service erodes compliance, the IRS will have to accept more noncompliance or spend more resources on (expensive) enforcement activities.[45] The IRS should quantify and explain these considerations and disclose them to the public.[46]

It may be less expensive in the long run (for the government but not necessarily the IRS) to provide IRS services without a fee, even if that means the IRS needs to reduce the resources it devotes to enforcement activity. About 98 percent of all revenue the IRS collects results from voluntary compliance, as compared to about two percent in enforcement revenue.[47] Moreover, Congress obviously intended for the IRS to focus on service, as it has reduced the IRS's budget for enforcement more severely than its budget for services in recent years.[48] Congress has long urged the IRS to focus on service. In 1998, it went so far as to direct the IRS to "restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs."[49]

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44 *See, e.g.*, Government Accountability Office, GAO-12-193, *User Fees: Additional Guidance and Documentation Could Further Strengthen IRS's Biennial Review of Fees* 18-19 (Nov. 2011) ("IRS officials consider factors other than cost recovery in setting fee rates. However, we found that IRS has not thoroughly documented these factors, corroborated anecdotal support with data analysis, or studied the effect of user fees on taxpayer behavior."); T.D. 9647, 78 Fed. Reg. 72016 (2014) (briefly referencing the goal of "encouraging the use of installment agreements"); Rev. Proc. 2015-8, § 6, 2015-1 I.R.B. 235 (2015) (no discussion of the basis for master and prototype volume submitter plan fees; no discussion of basis for Roth IRA recharacterization fee); Rev. Proc. 2015-1, App'x A(3), 2015-1 I.R.B. 1 (2015) (same); Rev. Proc. 2006-9, § 4.12, 2006-1 C.B. 278 (no discussion of basis for APA fee). The IRS did not publish the biennial reviews described above or any similarly detailed analysis.

45 Department of Treasury, *Congressional Justification for Appropriation and Annual Performance Report and Plan*, IRS-7 (2015) ("By assisting taxpayers with their tax questions before they file their returns, the IRS helps prevent inadvertent noncompliance and reduces burdensome post-filing notices and other correspondence from the IRS.").

46 This recommendation is generally consistent with OMB Circular A-4 (Sept. 17, 2003).

47 In FY 2015, the IRS collected total tax revenue of about $3.3 trillion. Of that amount, it collected $54.2 billion through enforcement actions. 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.

48 *Compare* Department of Treasury, *Congressional Justification for Appropriation and Annual Performance Report and Plan*, Table 2.3 (2011) (reflecting an appropriation of $2,278,830,000 for service and $5,504,000,000 for enforcement for FY 2010), *with* Department of Treasury, *Congressional Justification for Appropriation and Annual Performance Report and Plan*, Table 2.3 (2016) (reflecting an appropriation of $2,156,554 for service and $4,860,000 for enforcement for FY 2015).

49 The IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 722, Title I, § 1002 (1998).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise the IRM to require the IRS to avoid adopting (or retaining) a fee that would:
   - Have a significant negative impact on the IRS's service-oriented mission, voluntary compliance, or taxpayer rights and burden (including other compliance burdens taxpayers may face, such as the costs of hiring preparers or other third parties); or
   - Include fixed or indirect costs when demand for a service is in flux or that make the fee disproportionate to the value received.
2. Before establishing or raising any user fee, estimate the effect of the fee on demand for service, as needed to determine if the fee would impair the IRS mission, voluntary compliance, or taxpayer rights. This analysis should also demonstrate that the proposed fee does not pass along indirect or fixed costs or combine with other costs that would make it seem excessive from the taxpayer's perspective.
3. Publish the user fee analysis (described above) and address any comments from internal and external stakeholders before adopting or increasing a fee.

User Fees Memo

In the memo below, the National Taxpayer Advocate analyzes the most recently proposed fee increases under the principles described in the Most Serious Problem. However, the IRS has requested the redactions shown below.

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

December 4, 2015

MEMORANDUM FOR JOHN A. KOSKINEN
Commissioner of Internal Revenue

FROM: Nina E. Olson
National Taxpayer Advocate

SUBJECT: IRS User Fee Increases

You recently received recommendations to increase various user fees, which were developed by IRS business units (BUs) in connection with the IRS's FY 2015 Biennial User Fee Review. Particularly in light of the current budget situation, I am concerned that the BUs have not quantified or sufficiently considered:

- The indirect costs that are likely to result from fee increases;
- The effect of fee increases on taxpayer rights or burden;
- Any resulting reductions in voluntary compliance; or
- Any impairment of the IRS mission to "[p]rovide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."[1]

Although the sections below discuss TAS's concerns with each of the major user fee proposals, other internal and external stakeholders may have additional concerns. Thus, the IRS should engage in an open dialog with the public before determining whether to submit fee increases for approval, or at least before they are approved.

1 *See, e.g.*, IRS, Publication 1, *Your Rights as a Taxpayer* (2014); IRM 1.1.1.2, *IRS Mission* (June 2, 2015). In addition, if TAS (rather than the taxpayer) requests or orders the IRS to provide a service (*e.g.*, under IRC § 7811) on the basis that the taxpayer would otherwise suffer a significant hardship, it is not clear that the IRS would be authorized to withhold service if the taxpayer did not pay the fee. For example, to avoid a significant hardship, a taxpayer may need Appeals to expedite calculations or for Collection to withdraw a Notice of Federal Tax Lien (NFTL), but the IRS is considering fees for these services, as described below.

Offer in Compromise Fee Increase

[redacted] When the IRS determines a taxpayer is unlikely to be able to repay a delinquent tax debt, it may accept an offer to compromise the debt based upon "doubt as to collectibility."[3] The goal of the OIC program is for the IRS to collect what is reasonably collectible at the least cost and at the earliest possible time, and to promote future compliance by providing taxpayers with a "fresh start."[4] An accepted OIC also provides an extra incentive to report and pay future tax liabilities by requiring, as a condition of the OIC agreement, that the taxpayer file returns and pay taxes for the following five years.[5] Thus, an acceptable OIC is a good deal for both taxpayers and the government, and enhances voluntary compliance, furthering the IRS's mission to help taxpayers "meet their responsibilities." It is also consistent with the taxpayer *right to finality*, *to quality service*, and *to privacy*, which includes the right to expect that enforcement action will "be no more intrusive than necessary."[6]

When combined with the requirement for applicants to submit a down payment with an OIC,[7] the substantial OIC fee increase being considered — [redacted] — will almost certainly reduce utilization of the OIC program, thereby reducing voluntary compliance and impairing the IRS mission.[8] Because taxpayers generally have to fund an offer by selling illiquid assets that the IRS could not otherwise reach or convincing a non-liable party to pay, they are unlikely to make this effort unless they are sure the IRS will accept the offer. They cannot be sure the IRS will accept the offer up front when the fee is due.

As the IRS has acknowledged, "the fee for an offer in compromise could dissuade a low-income taxpayer from making an offer because the taxpayer cannot be assured of reaching an agreement."[9] The OIC fee could also dissuade taxpayers in every other income category from making offers. [redacted] Indeed, when the IRS first imposed a $150 OIC fee in 2003, OIC submissions declined by over 20 percent among taxpayers at every income level.[10] Further, in FY 2016 the Administration proposed to repeal the OIC down payment requirement based its conclusion that repealing the requirement

2 [redacted]

3 *See* IRC § 7122; Treas. Reg. § 301.7122-1; Form 656, *Offer in Compromise* (2015).

4 Policy Statement P-5-100, *reprinted at*, IRM 1.2.14.1.17, *Policy Statement 5-100* (Jan. 30, 1992).

5 Form 656, *Offer in Compromise* (2015). An IRS study found that about 80 percent of taxpayers in its sample with accepted OICs remained substantially compliant during the requisite period. Small Business/Self-Employed (SB/SE) Payment Compliance and Office of Program Evaluation and Risk Analysis (OPERA), *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program*, 6 (Sept. 2004).

6 *See, e.g.*, IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

7 Section 509 of the *Tax Increase Prevention & Reconciliation Act of 2005 (TIPRA)*, P.L. 109-223, effective July 16, 2006, imposed a requirement to submit a down payment with offer submissions.

8 Further, such a steep fee increase seems inconsistent with the Conference Report for the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98), which states "the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements." H.R. Rep. No. 105-599, at 288-89 (1998) (Conf. Rep.).

9 T.D. 9647, 78 F.R. 72016, 72017 (Dec. 2, 2013).

10 The Treasury Inspector General for Tax Administration (TIGTA) has concluded that the $150 OIC user fee, imposed in November 2003, was responsible for reducing OIC submissions by 28 percent overall. *See* TIGTA, Ref. No. 2005-30-096, *The Implementation of the Offer in Compromise Application Fee Reduced the Volume of Offers Filed by Taxpayers at All Income Levels* (June 2005). The smaller $36 increase in 2014 (from $150 to $186) would be less likely to trigger a significant reduction in OICs. *See* T.D. 9647, 78 F.R. 72016 (Dec. 2, 2013).

would raise revenue by improving access to the OIC program, which is less costly than other collection avenues.[11]

The IRS should estimate the effect of a [redacted] increase on demand for OICs, the resulting decline in future compliance, and the costs of trying to collect these debts (and future debts, which will continue to accrue) in some other way before considering an OIC fee increase. Any such analysis would probably find that it is less costly and burdensome to eliminate the OIC fee altogether than to increase it. The IRS should use such projections to help justify a full OIC fee waiver from the Office of Management and Budget (OMB).

Moreover, because the OIC fee reduces the amount the taxpayer can afford to pay on the offer, the OIC fee may be viewed as an accounting gimmick that elevates form over substance — like a tax shelter — allowing the IRS to retain and use funds that would otherwise return to the U.S Treasury in the form of higher offer amounts. The IRS should avoid giving this impression, which can only reduce respect for the IRS and the government — views which research shows correlate with noncompliance.[12]

If the IRS nonetheless pursues the OIC fee increase, it should minimize taxpayer burden by collecting the fee from the last OIC payment or at least in installments (for OICs structured that way), as it does when collecting the Installment Agreement (IA) fee. It should also waive the fee to the extent it would otherwise exceed the total OIC amount. For example, where the taxpayer can only pay $500, the fee should not exceed $500 and the IRS should accept an offer for $0, rather than rejecting the offer as insufficient or declining to process it because the taxpayer did not pay the fee. Although the OIC fee under consideration would not apply to low income taxpayers, rejecting or refusing to process such an offer would undermine IRC § 7122(d)(3)(A), which provides that "an officer or employee of the Internal Revenue Service shall not reject an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer."

Installment Agreement Fee Increase

The FY 2015 Biennial Review [redacted]

11 Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* 237 (Feb. 2015), *available at* http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx ("Requiring nonrefundable payments with an offer-in-compromise may substantially reduce access to the offer-in-compromise program. The offer-in-compromise program is designed to settle cases in which taxpayers have demonstrated an inability to pay the full amount of a tax liability. The program allows the IRS to collect the portion of a tax liability that the taxpayer has the ability to pay. Reducing access to the offer-in-compromise program makes it more difficult *and costly* to obtain the collectible portion of existing tax liabilities." (Emphasis added)). The administration's analysis must have applied to high income taxpayers because low income taxpayers are exempt from the down payment requirement. *See, e.g.*, IRC § 7122(c)(2)(C); IRS, Form 656, *Offer in Compromise* (2015).

12 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-56 (*Small Business Compliance: Further Analysis of Influential Factors*).

13 IRS response to TAS information request (Nov. 9, 2015). [redacted] *Id*.

14 IRS response to TAS information request (Nov. 9, 2015).

User Fees Memo

While an IA fee may seem reasonable on the basis that creditors charge financing fees to allow customers to pay over time, the IRS is not a commercial creditor. For taxpayers who cannot afford to pay their taxes timely and in full, the choice is to either pay their taxes (plus penalties and interest) using an IA or not to pay them. The choice for the IRS is to accept the IA, pursue enforced collection, or collect nothing. If enforced collection (or placing the taxpayer into currently not collectible (CNC) status) is more expensive, the government is the primary beneficiary when taxpayers agree to pay using IAs – at least they agreed to pay.[15]

The IRS should not discourage taxpayers from utilizing IAs by charging a fee that is difficult to avoid, particularly when they feel they cannot use the lower cost IA options. For example, some do not have bank accounts they could use to set up an online direct debit IA. Some do not have internet access or the computer literacy that would enable them to use the online IA application.[16] According to the U.S Census Bureau, more than 50 percent of the U.S. population with household income below $25,000 had no Internet access in 2013.[17] About 40 percent of the returns the IRS received for tax year (TY) 2013 (or 59.0 million out of 147.4 million) reported adjusted gross income of less than that amount.[18]

Even those with access may be concerned about entering their most sensitive financial information into a web application. Security breaches of the IRS's "Get Transcript" online application and the Office of Personnel Management (OPM)'s federal employee records have likely increased the public's anxiety in this area.[19]

Like offers, IAs promote voluntary compliance, furthering the IRS's mission to help taxpayers "meet their tax responsibilities." IAs are also consistent with the *right to quality service* and *to privacy*, which includes the right to expect that enforcement action will "be no more intrusive than necessary," as enforced collection would be more intrusive than an IA.[20]

To the extent that IA fees reduce IA utilization, they are likely to reduce voluntary compliance and damage the IRS's ability to further its mission. In theory, one might construe many routine IRS services as being eligible for a user fee, such as answering the telephone, processing a tax return, or sending a refund. Presumably, the IRS has decided that charging fees for these services does not make sense or would impair its mission. However, the IRS has not analyzed how IA fees make any more sense or impair its mission any less.

Even if the IRS does not believe an IA fee undermines its mission or reduces voluntary compliance, it should nonetheless project the effect of proposed IA fee increases on IA applications, voluntary compliance, and the cost to the IRS of dealing with these delinquencies in some other way before it decides whether to approve them. It could use such analysis to help justify a fee waiver from OMB.

15 Taxpayers sometimes even ask the IRS to levy their wages to avoid the IA user fee.

16 Only about 84 percent of American adults had Internet access in 2015, and those who are minorities, low income, poor, elderly, or who live in rural areas are less likely to have access. *See* Pew Research Center, *Americans' Internet Access*: 2000-2015 (June 26, 2015), http://www.pewinternet.org/files/2015/06/2015-06-26_internet-usage-across-demographics-discover_FINAL.pdf.

17 U.S. Census Bureau, ACS-28, *Computer and Internet Use in the United States: 2013*, 5 (Nov. 2014), *available at* http://www.census.gov/history/pdf/2013computeruse.pdf.

18 IRS Data Book, Table 1.1, *All Returns: Selected Income and Tax Items, by Size and Accumulated Size of Adjusted Gross Income* (TY 2013), *available at* http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

19 IRS, *IRS Statement on the "Get Transcript" Application* (May 26, 2015); OPM, *OPM to Notify Employees of Cybersecurity Incident* (June 4, 2015).

20 *See, e.g.*, IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

User Fees Memo

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

21 IRS response to TAS information request (Oct. 22, 2015) ([redacted], *2015 Biennial Review of SB/SE User Fees* [redacted] *Id*.

22 Program Manager Technical Advice (PMTA) 2009-158 (Oct. 8, 2009), *available at* http://www.irs.gov/pub/lanoa/pmta_2009-158.pdf ("[t]axpayers seek post-release withdrawals in order to improve their credit. This reason alone would not support a withdrawal under the first three sub-elements of section 6323(j)(1)… withdrawal can be said to be in the United States' best interests insofar as the improvement in the taxpayer's credit history assists him with future tax compliance.")

23 *See, e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 17, 29-30 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*); PMTA 2009-158 (Oct. 8, 2009).

24 IRM 1.1.1.2, *IRS Mission* (June 2, 2015).

25 IRS response to TAS information request (Nov. 9, 2015). For further discussion of this recommendation, *see, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 402-25; National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 108-30; National Taxpayer Advocate 2011 Annual Report to Congress 109-28; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111; National Taxpayer Advocate 2010 Annual Report to Congress 302-10; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18.

User Fees Memo

[redacted]

[redacted]

[redacted]

[redacted]

26 IRS response to TAS information request (Oct. 22, 2015) [redacted]

27 *See* IRC § 6109; Treas. Reg. § 301.6109-1(d)(3); Instructions to IRS Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Feb. 2012). For the Bank Secrecy Act requirement, see *generally* Bank Secrecy Act, 31 U.S.C. §§ 5311-5314, 5316-5322; 12 U.S.C. § 1829(b); USA Patriot Act, § 326, Pub. L. No. 107-56, 115 Stat. 307 (2001); 31 C.F.R. §§ 1010.410, 1010.620, 1022.400.

28 IRS, *IRS Strengthens ITIN Application Requirements; Interim Changes Will Protect the Integrity of the ITIN Process*, IR-2012-62 (June 22, 2012), *available at* https://www.irs.gov/uac/Newsroom/IRS-Strengthens-ITIN-Application-Requirements;-Interim-Changes-Will-Protect-the-Integrity-of-the-ITIN-Process; National Taxpayer Advocate 2012 Annual Report to Congress 152, 163.

29 If the applicant is a dependent (other than a military dependent), the AA will still send the identifying document to Austin. *See* IRS, *Instructions for Form W-7*, *Application for IRS Individual Taxpayer Identification Number*, 3 (2014). If the applicant is using anything other than an original passport or national identification card (*e.g.*, a copy of an original document certified by the issuing agency) at least some TACs will still send the document to Austin. *See*, IRS, *Individual Taxpayer Identification Number (ITIN) Authenticating Taxpayer Assistance Centers* (Mar. 12, 2015), *available at* http://www.irs.gov/uac/ITIN-Authenticating-TACs-Link (last visited Nov. 10, 2015).

30 IRS, *2012 ITIN Review, Frequently Asked Questions* (Apr. 23, 2015), *available at* http://www.irs.gov/uac/2012-ITIN-Review-Frequently-Asked-Questions-1 (last visited Sept. 24, 2015).

31 The IRS has a responsibility to ensure it returns these original documents safely and promptly, but returning them by express mail could cost in the range of $1.2 to $4.1 million, making it more economical for the IRS to review the documents at a TAC or to allow a AA to review them. Conference call between TAS and IRS W&I, discussing *Authenticating Identification Documents at SPEC, AA and VITA Sites* (Oct. 29, 2015).

32 IRS response to TAS information request (Oct. 22, 2015) (Memo from Commissioner, W&I Division to CFO, B*iennial Review of User Fee Charges* (June 19, 2015)).

User Fees Memo

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[redacted]

[redacted]

33 During calendar year 2015 dependents made up 43.8 percent of ITIN applicants, but they cannot use AAs to avoid parting with their documents because, as noted above, the AAs have to mail their original documents to the IRS. IRS, Compliance Data Warehouse, Form W-7 Database (Oct. 2, 2015). Moreover, only 21 countries around the world have AAs, with some big countries like India or Brazil only having one or two. IRS, *Acceptance Agent Program, available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (Oct. 27, 2015).

34 *See* National Taxpayer Advocate 2012 Annual Report to Congress 152, 159. In evaluating the pros and cons of this fee, the IRS acknowledges that it "may reduce voluntary tax compliance." IRS response to TAS information request (Oct. 22, 2015).

35 IRM 1.1.1.2, *IRS Mission* (June 2, 2015).

36 IRS response to TAS information request (Oct. 22, 2015) (CFO Briefing).

37 IRS response to TAS information request (Oct. 22, 2015) (Memo from SB/SE Commissioner to CFO, *2015 Biennial Review of SB/SE User Fees* (June 18, 2015)). [redacted]

38 IRS, Letter 627, *Estate Tax Closing Letter* (2007) ("This letter is evidence that the Federal Estate Tax Return has either been accepted as filed or has been accepted after an adjustment to which you have agreed. You should keep this letter as a permanent record. You may need it to close probate proceedings, transfer title to property and/or settle state taxes…. We will not reopen or examine this return unless you notify us of changes to the return or there is: (1) evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact; (2) a clearly defined substantial error based upon established Internal Revenue Service position; or (3) a serious administrative error. (See Revenue Procedure 2005-32, 2005-1 Cumulative Bulletin 1206.)").

39 *See, e.g.*, IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

User Fees Memo

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

40 IRS response to TAS information request (Oct. 22, 2015).

41 *Id*. The IRS could waive the fee if the government caused a delay that resulted in the need for expedited calculations. *Id*. The IRS has also suggested that the processing time is almost always shorter for low-dollar disputes, obviating the need for an expedite fee. IRS response to TAS fact check (Nov. 13, 2015).

42 IRS response to TAS information request (Nov. 9, 2015). According to the IRS, this estimate is an approximation. IRS response to TAS fact check (Nov. 13, 2015).

43 IRM 8.1.1.1(1) *Accomplishing the Appeals Mission* (Feb. 10, 2012).

44 IRS response to TAS information request (Oct. 22, 2015). Appeals proposed to apply the fee only to examination cases because taxpayers already pay a fee for offers. *Id*. Its revenue estimate assumes the fee would not discourage any taxpayers from mediation. *Id*.

45 IRC § 7123(b)(1) ("The Secretary shall prescribe procedures under which a taxpayer or the Internal Revenue Service Office of Appeals may request non-binding mediation on any issue unresolved at the conclusion of— (A) appeals procedures; or (B) unsuccessful attempts to enter into a closing agreement under section 7121 or a compromise under section 7122.")

User Fees Memo

46 *See* IRM 8.1.1.1(1), *Accomplishing the Appeals Mission* (Feb. 10, 2012) ("The Appeals Mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.").

47 Rev. Proc. 2015-44, 2015-38 I.R.B. 354 ("Although Appeals arbitration is being eliminated, taxpayers may be eligible to request mediation for unresolved issues that remain after completion of settlement discussions in Appeals. *See* Rev. Proc. 2014-63, 2014-53 I.R.B. 1014.")

48 Rev. Proc. 2014-63, § 9.01, 2014-53 I.R.B. 1014.

49 IRS response to TAS information request (Oct. 22, 2015).

50 *See* Rev. Proc. 2012-31, 2012-33 I.R.B. 256.

51 IRS, *FOIA Guidelines* (Appendix B, Fee Schedule), *available at* https://www.irs.gov/uac/Freedom-of-Information-Act-(FOIA)-Guidelines#Fees (last updated Sept. 3, 2015).

52 Memo for Distribution from Deputy Commissioner for Operations Support and Deputy Commissioner for Services and Enforcement, *Freedom of Information Act (FOIA) Obligations* (Aug. 24, 2011); IRS, Routine Access to IRS Records" *available at* http://www.irs.gov/uac/Routine-Access-to-IRS-Records ("If you [taxpayer] are working with an IRS employee on an open case, you may request information from the case file (such as copies of workpapers or other records) directly from the IRS employee assigned to the matter."). *See also* IRM 4.26.14.4(2)(b) (July 24, 2012).

53 *See* TIGTA, Ref. No. 2015-30-084, *Fiscal Year 2015 Statutory Review of Compliance With the Freedom of Information Act* 12 (Sept. 18, 2015) (showing the FOIA backlog).

User Fees Memo

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[redacted]

Pre-Filing Agreements and Advance Pricing Agreement Fees

[redacted] The PFA procedure allows taxpayers under the jurisdiction of the Large Business and International Division (LB&I) to undergo an examination and reach an agreement (a

54 Treas. Reg. §§ 601.702(c)(12)-(c)(13).

55 IRS response to TAS information request (May 20, 2015).

56 IRS response to TAS information request (Oct. 30, 2015).

57 IRS response to TAS information request (May 20, 2015) (attachment G).

58 IRS response to TAS information request (Oct. 30, 2015) (Memo from Commissioner, TE/GE to CFO, *FY 2015 Biennial Review of User Fee Charges* (July 21, 2015)).

59 IRS response to TAS information request (Oct. 22, 2015) (FY 2015 Biennial Review of User Fee Charges, Attachment 2).

PFA) with the IRS about how specific items should be reported before the returns are filed.[60] Similarly, the IRS describes the APA program as "a voluntary process whereby the IRS and taxpayers may resolve transfer pricing issues and issues for which transfer pricing principles may be relevant in a principled and cooperative manner on a prospective basis."[61] In other words, both of these agreement programs further the IRS mission, improve voluntary compliance, reduce controversy, save resources, and implement the taxpayer rights *to be informed*, *to quality service*, *to pay no more than the correct amount of tax*, *to finality*, *to privacy*, and *to a fair and just tax system*. Yet, the IRS only offers them to taxpayers willing to pay a very steep fee.

While the taxpayers who use these programs can mostly afford to pay the fees being considered, ability to pay should not be the sole basis for imposing a fee. If it charges a fee, the IRS should articulate a basis for doing so that does not, in essence, charge taxpayers for services that further the IRS mission (*i.e.*, charge them when it is simply doing its job more effectively than usual).

Although only the government can audit returns and sign closing agreements with taxpayers, one potential basis for imposing a fee for these programs may be that the IRS would otherwise compete with tax practitioners and accounting firms, who may also examine a taxpayer's records and provide opinions about the accuracy/certainty of the tax treatment of the items it reflects.[62] On that basis it might be reasonable for the government to charge for its fact-finding or examination activities (assuming these taxpayers were not certain to be examined in any event), but not for executing the closing agreement itself, which only the government can do. This might also provide a basis for the IRS to explain to the public why the agreement programs that it charges for (*i.e.*, the PFA and APA programs) are different from a similar agreement program that LB&I does not charge for — the Compliance Assurance Process (CAP).[63] Specifically, taxpayers eligible for CAP are already under continuous audit — a function only the government can undertake — making it even less reasonable for the IRS to charge for the audit or fact-finding component of the program. Moreover, the IRS should explain to the public why — aside from its own budget situation — it is suddenly increasing [redacted].

[redacted]

60 Rev. Proc. 2009-14, 2009-3 I.R.B. 324; IRM 4.60.8.3.4, *IMS Procedures in APA Cases* (June 5, 2014); IRM 4.30.1.1(1) (Jan. 9, 2002) ("The pilot demonstrated that PFAs were cost efficient, they allowed taxpayers to file more compliant tax returns within prescribed time frames, taxpayer burden decreased and both the IRS and taxpayers conserved resources.").

61 Rev. Proc. 2015-41 § 2.02(2), 2015-35 I.R.B. 263 (also noting "[T]he APA process increases the efficiency of tax administration by encouraging taxpayers to come forward and present all the facts necessary for a proper evaluation of their proposed covered issues and to work towards a resolution of such issues in a spirit of openness and cooperation."). *See also* IRM 4.60.8.3.3, *Advance Pricing Agreement (APA) Cases* (June 5, 2014).

62 *See* National Taxpayer Advocate 2007 Annual Report to Congress 66, 68 ("[W]hen government and private businesses provide the same services, user fees may also help keep the government from stifling private-sector competition.").

63 CAP is a program that allows large businesses under continuous audit to, in effect, have the IRS audit the return before it is filed, increasing voluntary compliance and reducing the burden of post-filing examinations for both the IRS and taxpayers. *See, e.g.*, IRM 4.51.8, *Compliance Assurance Process (CAP) Examinations* (Sept. 25, 2015).

64 [redacted] response to TAS information request (Nov. 9, 2015).

User Fees Memo

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[redacted]

[redacted]

[redacted]

65 IRS response to TAS information request (May 20, 2015) (attachment A); IRM 1.1.11.4, *Office of National Public Liaison* (Feb. 12, 2015).

66 IRS response to TAS information request (Oct. 22, 2015) (2015 Biennial Review, Attachment 2); IRS response to TAS information request (Nov. 3, 2015).

67 [redacted]

68 [redacted]

69 [redacted]

70 IRM 1.32.19.20, *Review and Implementation of New User Fees* (Nov. 8, 2012).

User Fees Memo

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

71 IRS response to TAS fact check (Nov. 13, 2015).

72 Ann. 2006-74, 2006-2 C.B. 746 (Oct. 16, 2006); IRS, *IRS Income Verification Express Service* (Sept. 14, 2015), *available at* https://www.irs.gov/Individuals/Income-Verification-Express-Service.

73 *See, e.g.*, Form 4506T, *Request for Transcript of Tax Return* (2015); Form 4506T-EZ, *Short Form Request for Individual Tax Return Transcript* (2014).

74 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

75 The Tax Increase Prevention Act of 2014, Tax Technical Corrections Act of 2014, and Achieving a Better Life Experience (ABLE) Act of 2014, Pub. L. No. 113-295 § 206, 128 Stat. 4010, 4065-4073 (Dec. 19, 2014) (codified at IRC §§ 3511, 7705, 3302, 3303, 6053, 6652, and 7528(b)(4)).

76 IRC § 7528(b)(4).

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

RESPONSIBLE OFFICIAL

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

In 2014, over the objections of the National Taxpayer Advocate and other stakeholders, the IRS began addressing backlogs in its inventory of applications for tax-exempt status by allowing certain organizations to use new Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.[2] 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.

Unlike Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, Form 1023-EZ does not solicit any narrative of the organization's activities, any financial data, any substantiating documents, or any explanatory material.[3] 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.[4]

Experience thus far with the "streamlined" application procedures that Form 1023-EZ exemplifies has not been encouraging:

- IRS audits demonstrate that eight percent of Internal Revenue Code (IRC) § 501(c)(3) organizations do not make required changes to their organizing documents even after they attest they have done so;[5]

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 See National Taxpayer Advocate Fiscal Year (FY) 2015 Objectives Report to Congress 54-7. Among other things, organizations eligible to submit Form 1023-EZ must generally have annual gross receipts of less than $50,000 and assets of less than $250,000.

3 Form 1023-EZ applicants, who must file electronically, cannot submit anything with the application other than the three-page form itself, even if they want to.

4 See Patricia Cohen, *I.R.S. Shortcut to Tax-Exempt Status Is Under Fire*, N.Y. Times (Apr. 9, 2015) (noting "[a]n unlikely coalition of tax lawyers, state enforcement agents and even many nonprofits that favor simpler rules say that the agency — by not asking any questions about governance, conflicts of interest or function, and saying applicants don't have to reveal any such issues — is making it too easy to commit fraud").

5 Tax Exempt and Government Entities (TE/GE) Division Second Qtr Business Performance Review (BPR) 2015 at 2 (May 2015).

- The IRS's own analysis of a representative sample of Form 1023-EZ filers shows that the IRS approves a significant number of applications it would have rejected had the applications been subject to a slight amount of scrutiny;[6]
- TAS's analysis of a representative sample of Form 1023-EZ applicants whose applications were approved by the IRS shows that 37 percent were not, as a matter of law, IRC § 501(c)(3) organizations; and[7]
- The frequency at which IRC § 501(c)(3) organizations were referred to the Exempt Organization (EO) Examination function increased almost ninefold from FY 2014 to FY 2015.[8]

As the Tax Exempt and Government Entities division (TE/GE) acknowledges, the IRS intends to address the "perceived inadequate oversight" that stems from its new Form 1023-EZ procedures by shifting more resources to audits. This back-end, labor-intensive approach invites noncompliance, diverts tax dollars and taxpayer donations, and harms taxpayers that could have adjusted their organizing documents or the activities they pursued if the IRS had advised them of the need to do so from the outset.[9] While audits serve a role in furthering taxpayer compliance, they are no substitute for preventive, front-end efforts to avoid compliance issues in the first place. Thus, the proposed 1023-EZ audit strategy is a misallocation of IRS resources and an unnecessary burden on compliant exempt organizations.

ANALYSIS OF PROBLEM

The Law Requires an Exempt Entity's Organizing Document to Contain Key Elements, and It Is Not Difficult to Determine Whether the Requirements Are Met

In order to be exempt from tax as an IRC § 501(c)(3) organization, an entity's organizing documents must establish that it is "organized and operated exclusively" for one of eight enumerated exempt purposes.[10] Form 1023 requires applicants to submit their organizing documents; instructions for the form explain the need for and provide examples of appropriate purpose and dissolution clauses.[11] By inspecting organizing documents and withholding exempt status until the organization's documents meet the legal

6 TE/GE, *Form 1023-EZ First Year Report* 5; EO Response to TAS information request (Oct. 29, 2015).

7 *See Study of Taxpayers that Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra*, (describing TAS's analysis of a representative sample of 408 corporations obtaining exempt status on the basis of Form 1023-EZ located in one of 20 states that make articles of incorporation available online at no cost). Reports of increased levels of customer satisfaction with Form 1023-EZ are not surprising, given that recognition as an IRC § 501(c)(3) organization is now easily available to some organizations that do not actually qualify for that status. *See* Diane Freda, *Exempt Organizations: First Year Survey of Form 1023-EZ Confirms Popularity*, BNA Daily Tax Report (Dec. 5, 2015).

8 TE/GE responses to TAS information request (June 11, 2015; Nov. 25, 2015).

9 TE/GE BPR First Qtr 2015 Appx. B, TE/GE Risk Register (Feb. 2015) (noting that "[p]erceived inadequate oversight of the tax-exempt sector as we undertake strategic shifts in how we conduct the up-front review of applications for tax-exempt status…" will be mitigated by "[e]xpanded compliance efforts.").

10 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (providing "[a]n organization is organized exclusively for one or more exempt purposes *only* if its *articles of organization*," among other things, limit the purposes of such organization to one or more exempt purposes); Treas. Reg. § 1.501(c)(3)-1(b)(4) (providing "[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, *by reason of a provision in the organization's articles* or by operation of law, be distributed for one or more exempt purposes…" (emphasis added)). In nine states, sometimes referred to as *cy pres* states, a dissolution clause is not required because by operation of state law, the organization's assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. *See* Rev. Proc. 82-2, 1982-1 C.B. 367; Tex. Bus. Orgs. Code Ann. § 22.304(a)(2) (2012).

11 *See* Part II of Form 1023; Instruction, Form 1023 at 7 (providing examples of acceptable purpose and dissolution clauses).

requirements, EO can correct noncompliance and avert noncompliance that might otherwise arise as the organization operates.

On the other hand, when EO fails to inspect articles of incorporation, it risks recognizing as IRC § 501(c)(3) organizations those that do not meet the legal requirements. For example, the IRS recognized as tax-exempt a Form 1023-EZ applicant whose articles of incorporation describe its purpose as:

> My father [named individual], sufferred [sic] a spinal cord injury in February 2013, which left him a quadriplegic [sic]. His physicians and physical therapists say he is capable of recovering and walking again but his insurance ([name of State] Medicaid) will not cover the expense, so we are hosting fundraisers/benefits to try to raise the money on our own to pay for his therapy out of pocket.[12]

This description raises serious doubts about whether the applicant intends, or would even be permitted by its articles, to serve a public, as opposed to a private, interest. Presumably, if EO had reviewed these articles of incorporation before conferring exempt status, it would have required additional information and insisted on changes to the articles before granting exempt status.

It appears that reviewing an applicant's case file and its articles of incorporation and then requesting amendments to the articles of incorporation takes the Tax Exempt and Government Entities Exempt Organizations function about an hour. This is a small price to pay to prevent waste, error, and abuse.

As another example, the IRS recognized as exempt a corporation whose articles are devoid of any purpose clause or description of current or planned activities (and do not allow any insight about what those activities may be), and contain the following dissolution clause: "Assets will be distributed to registrant of entity [individual taxpayer's name], if this nonprofit dissolves."[13] Assets that are ultimately destined for the founder's or some other individual's pocket cannot be viewed as dedicated to an exempt purpose. Had EO reviewed these articles of incorporation before it conferred exempt status, it presumably would have required their amendment.

TAS evaluated articles of incorporation of a representative sample of approved Form 1023-EZ filers incorporated in the 20 states in which the Secretary of State maintains a website that permitted TAS to view legible copies of articles of incorporation at no charge to determine whether they meet the organizational test. Such review took about three minutes on average and identified a significant portion of organizations whose applications have been erroneously approved.[14] It appears that reviewing an applicant's case file and its articles of incorporation and then requesting amendments to the articles of incorporation takes EO about an hour.[15] This is a small price to pay to prevent waste, error, and abuse.

12 This is the entire text that appears as the "purposes/nature of the business" in the articles of incorporation of an organization included in a representative sample of corporations whose Form 1023-EZ application was approved. *See Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra*.

13 This is the actual entire dissolution clause in the articles of incorporation of an organization included in a representative sample of corporations whose Form 1023-EZ application was approved. *Id*.

14 *Id*.

15 TE/GE response to TAS information request (June 11, 2015), noting "anecdotally, employees charge approximately one hour to review a case file, check the state website, and write an additional information letter which would include the request for the Articles of Incorporation and/or amendments, as needed."

For Years, the Form 1023 Application Process Was Plagued by Delay

In the decade prior to the introduction of Form 1023-EZ, the National Taxpayer Advocate voiced concerns about delays in processing applications submitted on Form 1023.[16] By 2012, the volume of EO's open inventory was 36,034 cases, applications requiring little or no development were taking four months to close, and applications requiring assignment to a reviewer were taking nine months just to be assigned.[17] By 2013, the application inventory backlog stood at about 66,000 cases, and applications requiring review took a year and a half to be assigned.[18]

The National Taxpayer Advocate has, since 2011, recommended that the IRS develop a Form 1023-EZ for use by small organizations.[19] Little did she know that the IRS, after initially dismissing the suggestion outright, would ultimately take that idea and run with it to the point of absurdity.

The Tax Exempt and Government Entities Exempt Organizations function approved Form 1023-EZ applications much less frequently — 77 percent of the time, compared to 95 percent of the time — when it requested documents or basic information from the applicants, rather than relying on the attestations contained in the form.

EO Implemented Streamlined Procedures That Addressed the Form 1023 Inventory Backlog But at the Price of Actual Oversight

In October and November of 2013, as part of a three-week pilot project, EO adopted "streamlined procedures" to address its existing inventory backlog of applications submitted on the 12-page Form 1023 that needed further development. These procedures allowed some applicants to provide "assurance of meeting the organizational and operational tests through representational attestations" rather than by submitting substantiating documents.[20] EO expanded the project in January of 2014 and now uses streamlined procedures to evaluate *all* Form 1023 applications.[21] For example, if the applicant is a corporation and does not submit its articles of incorporation as required, the agent reviewing the application may retrieve the articles from official online State records, and if the corporation is legally formed and appears to otherwise qualify for favorable determination under IRC § 501(c)(3), the agent simply asks the organization for confirmation.[22] On the other hand, if the articles of incorporation do not meet the organizational test, but the applicant appears to otherwise qualify for favorable determination and no other organizing document issues need to be addressed, the agent merely asks the applicant to attest that the articles have been amended to correct the deficiency (but the organization is not required to submit amended articles).[23]

16 *See, e.g.*, National Taxpayer Advocate 2004 Annual Report to Congress 193 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*); National Taxpayer Advocate 2011 Annual Report to Congress 437 (Status Update: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*).

17 National Taxpayer Advocate 2012 Annual Report to Congress 192, 196, 205.

18 National Taxpayer Advocate 2013 Annual Report to Congress 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*).

19 National Taxpayer Advocate 2011 Annual Report to Congress 437, 444, 562.

20 *See Proposal to Apply the Concepts from the Streamlined Application Process Pilot to Existing Inventory*, attached to TEGE-07-0215-0005, *Reissued Streamlined Processing Guidelines for All Cases* (Feb. 27, 2015).

21 *Id.*

22 TEGE-07-0315-0006, *Streamlined Processing Guidelines for All Cases* (Mar. 12, 2015). More than 20 states currently make corporations' articles of incorporation viewable online free of charge. TE/GE Third Qtr BPR 2015 at 5 (Aug. 2015).

23 TEGE-07-0315-0006, *Streamlined Processing Guidelines for All Cases* (Mar. 12, 2015).

TE/GE has begun to audit some filers that obtained exempt status using streamlined procedures.[24] As of March 27, 2015, TE/GE had started 284 audits and closed 51.[25] Of the closed audits of IRC § 501(c)(3) organizations, eight percent failed to meet the organizational test at the time the examination commenced, even though they had already interacted with TE/GE after they had filed Form 1023 — *i.e.*, assuming that TE/GE followed its own procedures, after reviewing the Form 1023, it notified the organizations of the deficiencies in their organizing documents and the organizations attested that those deficiencies had been corrected.[26] For the amount of time it took to correspond with and audit these organizations, EO could have required a copy of the amended articles after its initial review in the application phase, making certain, while it had the organizations' attention and leverage over them, that they met the organizational test. Instead, the IRS substituted an exchange of correspondence (and issued a favorable determination letter) for actual oversight of organizations it knew were not compliant.

The IRS Approved Virtually All Form 1023-EZ Applications, Despite Its Own Analysis Showing Form 1023-EZ Provides Insufficient Information

In the first year after introduction, EO approved 95 percent of applications submitted on Form 1023-EZ.[27] When it introduced Form 1023-EZ, TE/GE committed to review a sample of Form 1023-EZ applications in greater detail before making a determination.[28] As of June 26, 2015, EO had selected 1,191 organizations for pre-determination review, and had closed 965 of these 1,191 cases.[29] EO agents requested additional information from these applicants, such as "the organizing document with language required to meet the organizational test" and "a detailed description of past, present, and future activities; revenues and expenses."[30] As Figure 1.3.1 shows, EO approved Form 1023-EZ applications much less frequently — 77 percent of the time, compared to 95 percent of the time — when it requested documents or basic information from the applicants, rather than relying on the attestations contained in the form.

24 In 2014, TE/GE began a post-determination audit program of organizations (both Form 1023 filers and those that filed Form 1024, *Application for Recognition of Exemption Under Section 501(a)*) that received exempt status from April - September 2014 under the streamlined procedures. Correspondence audits of a statistical sample of these organizations began in October 2014, with the plan of starting 1,400 new audits and closing 1,200 in FY 2015. *See Post-Determination Compliance (PDC) Examinations*, TE/GE BPR Second Qtr 2015 at 2 (May 2015).

25 TE/GE Second Qtr BPR 2015 at 2 (May 2015).

26 TE/GE's third quarter BPR reports that as of June 26, 2015, TE/GE had closed 204 audits, but does not report how many organizations failed to meet the organizational test at the time the audit commenced. TE/GE Third Qtr BPR 2015 at 7 (Aug. 2015). TE/GE requests any necessary amendments to organizing documents during the audit process. TE/GE response to TAS information request (June 11, 2015).

27 TE/GE Third Qtr BPR 2015 at 4 (Aug. 2015) (reporting that in the year since it introduced Form 1023-EZ, EO received 43,157 Form 1023-EZ applications). It closed 42,089, of which it approved 39,907, an approval rate of 95 percent.

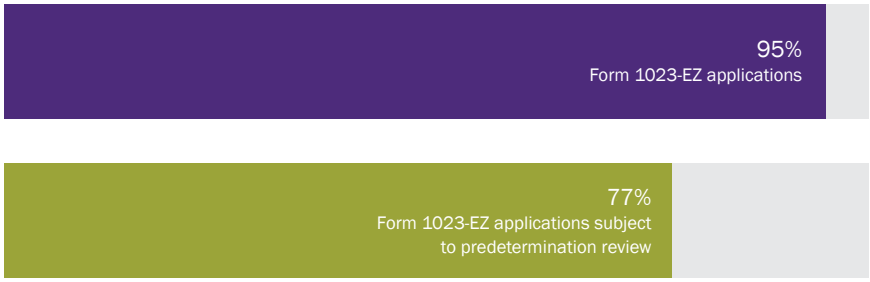
28 *See* Rev. Proc. 2014-40, § 5.03, 2014-30 I.R.B. 229 (providing that "the Service will select a statistically valid random sample of Forms 1023-EZ for pre-determination reviews"); Rev. Proc. 2015-5, § 5.03, 2015-1 I.R.B. 186 (providing the same). Interim guidance to employees describes as the goals of the review to: "Identify applicants that do not qualify for exemption; Identify applicants that are not eligible to file Form 1023-EZ (those that should have completed the full Form 1023); Gauge the effectiveness of Form 1023-EZ (*i.e.*, identify situations in which a streamlined application was not appropriate such as where the activities should have been addressed in full development); Learn about the population of organizations applying for exemption using Form 1023-EZ; Enhance public trust by reinforcing that submission of Form 1023-EZ does not guarantee tax exemption will be recognized." TEGE-07-0714-0017, *Interim Guidance on Processing Form 1023-EZ* (July 1, 2014).

29 TE/GE, *Form 1023-EZ First Year Report* 5-6, EO Response to TAS information request (Oct. 29, 2015).

30 *Id*.

FIGURE 1.3.1[31]

Form 1023-EZ Approval Rates



EO rejected 152 applications included in the pre-determination review sample because the organization was ineligible to apply using Form 1023-EZ (even though Form 1023-EZ applicants attest they have completed an Eligibility Worksheet included in the instructions to the form and are eligible to use the form), or because the organization did not respond to the request for additional information.[32] It is possible that these applicants would qualify as IRC § 501(c)(3) organizations. However, as of March 27, 2015, EO had also identified 181 cases in which a review of the organization's articles of incorporation revealed that the applicant did not initially meet the organizational test, despite their attestations to the contrary.[33] Even assuming that no further such organizations were identified by the time TE/GE made its determinations in all 965 cases it had closed by June 26, 2015, the 181 organizations that did not initially meet the organizational test represent a rate of noncompliance of almost 20 percent.[34]

31 TE/GE, *Form 1023-EZ First Year Report* 5, EO Response to TAS information request (Oct. 29, 2015).

32 *Id.* at 5-6, EO Response to TAS information request (Oct. 29, 2015) (reporting that 68 applications were rejected because the applicant was not eligible to apply using Form 1023-EZ and 84 applications were rejected because the organization did not respond to a request for additional information). Because TE/GE adopted the practice of making follow-up calls to nonresponsive organizations, the rate of nonresponse has declined from 12 percent of all applications (in the first six months of Form 1023-EZ processing) to six percent (in the second six months of Form 1023-EZ processing), which has presumably resulted in an increase in the approval rate.

33 TE/GE response to TAS information request (June 11, 2015). In those cases, EO requested the organizations to amend their organizational documents and accepted an attestation, under penalties of perjury, that the document had been amended to include the required provisions.

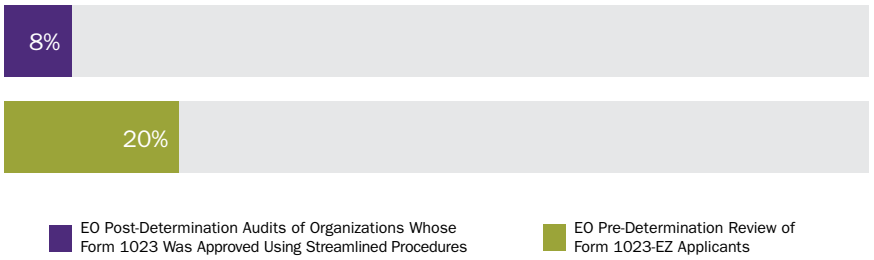
34 Moreover, EO's initial review of the description of the organization's activities identified 40 organizations that did not meet the operational test. To the extent these 40 organizations were not already counted among those that failed the organizational test, the rate of noncompliance was greater than 20 percent. In these cases, EO requested clarification in an additional information letter, or, as happened in four cases, if the description indicated the applicant could qualify under a different subsection of the Code, such as IRC § 501(c)(4), EO asked the organization to reapply on Form 1024. In one case, the description indicated the applicant did not qualify for recognition of exemption, and EO advised the applicant it would propose an adverse determination. TE/GE response to TAS information request (June 11, 2015). Ultimately, 21 of the 40 applications were approved. Fifteen applications were rejected (eight because the organization did not respond to the request for information, six were not eligible to use Form 1023-EZ, and one had an invalid EIN. Four organizations appeared to not qualify as IRC § 501(c)(3) organizations and withdrew their applications (three of these four were encouraged to reapply by submitting Form 1024). TE/GE response to TAS information request (Oct. 27, 2015).

Figure 1.3.2 summarizes the rate at which EO's own analyses showed that organizations did not meet the organizational test, as demonstrated by the two separate review or audit programs:

- EO's post-determination audits of organizations whose Form 1023 was approved using streamlined procedures; and
- EO's pre-determination review of a representative sample of organizations that submitted Form 1023-EZ.

FIGURE 1.3.2[35]

Rate at Which Applicants for Exempt Status Did Not Meet Organizational Test for Qualification as an IRC § 501(c)(3) Organization



TAS Analysis of Approved Organizations Shows Many Did Not Meet the Requirements for Exempt Status, Often for Reasons They Could Have Easily Corrected Had EO Reviewed Their Documents

From July through September 2015, TAS reviewed a representative sample of 408 organizations whose Form 1023-EZ applications were approved.[36] The analysis showed that 149, or 37 percent, of the organizations in the sample did not satisfy the organizational test. Of these 149 organizations, 22 appeared to have an adequate purpose clause, but lacked a sufficient dissolution clause (where one was required), a condition the organizations could have easily corrected had they been advised to do so. For some organizations, an exempt purpose could be inferred even though the articles did not have an adequate purpose clause. These organizations might very well have been able to craft an accurate, tax-compliant purpose clause had they been advised of the need to do so, and correcting that deficiency might have averted future noncompliance as they commenced or continued their operations.

The numbers show that the IRS is actually undermining compliance by failing to take simple prophylactic measures, such as requesting and reviewing an applicant's organizing documents, before conferring exempt status.

35 TE/GE Second Qtr BPR 2015 at 2 (May 2015); TE/GE response to TAS information request (June 11, 2015).

36 *See Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra* (describing TAS's analysis of a representative sample of 408 corporations obtaining exempt status on the basis of Form 1023-EZ located in one of 20 states that make articles of incorporation available online at no cost).

From July through September 2015, TAS reviewed a representative sample of 408 organizations whose Form 1023-EZ applications were approved. The analysis showed that 149, or 37 percent, of the organizations in the sample did not satisfy the organizational test.

The IRS Intends to Audit Its Way Out of the Potential Noncompliance It Helped Create

TE/GE will begin correspondence audits of Form 1023-EZ filers in FY 2016, selecting cases through a statistical sample of organizations that have operated for a complete tax year after receiving a determination letter.[37] However, TE/GE, rather than sampling from all organizations that received exempt status on the basis of Form 1023-EZ, will only sample from approved Form 1023-EZ filers that filed a 990-series return.[38] E-Postcard submitters are required to submit the e-Postcard annually, and will lose their exempt status if they fail to do so, but only if the failure persists for three consecutive years.[39] To the extent organizations required to submit an e-Postcard do not do so every year, TE/GE will have an incomplete sample of approved Form 1023-EZ filers. It remains to be seen whether, if the post-determination audits of Form 1023-EZ filers show high levels of noncompliance, TE/GE will adjust its procedures by strengthening its initial review process.

We also note that from FY 2014 to FY 2015, the frequency with which EO Determinations employees referred IRC § 501(c)(3) organizations to TE/GE's EO Examination function increased almost ninefold.[40] In view of the fact that this surge in referrals coincided with the introduction of Form 1023-EZ, TE/GE might gain further insight into compliance levels of Form 1023-EZ filers by analyzing these referrals in greater detail.

To its credit, TE/GE is implementing a broader compliance risk framework, expected to unfold over several years, that entails defining and measuring compliance for the exempt organization population. It plans to divide the population into meaningful market segments, grouped by common traits, behavior, and interactions with the IRS. It will then (1) select a random sample for each market segment, both to establish an initial baseline compliance rate and to develop a market segment-specific compliance risk model; (2) assign different treatment types to each organization based on its risk score; and (3) re-evaluate the model and treatments based on the results.[41] The National Taxpayer Advocate has long advocated for more research into the behavior, needs, and preferences of exempt organizations.[42] This work is very important, as the National Taxpayer Advocate noted in 2007 and 2009, and it is not mutually exclusive with the pre-determination oversight we recommend. In fact, the approaches work hand in hand.

37 TE/GE response to TAS information request (June 11, 2015).

38 TE/GE, *Form 1023-EZ First Year Report* 9, EO Response to TAS information request (Oct. 29, 2015).

39 IRC § 6033(j).

40 In FY 2014, EO Exam received 19 referrals from EO Determinations employees for all IRC § 501(c)(3) organizations, without distinction between Form 1023 and Form 1023-EZ filers. For FY 2015, EO Exam received 184 such referrals, an almost nine-fold increase. TE/GE responses to TAS information request (June 11, 2015; Nov. 25, 2015).

41 TE/GE response to TAS information request (June 11, 2015).

42 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 197, 209 (recommending that the IRS conduct an exempt organization Taxpayer Assistance Blueprint (TAB) to study exempt organizations' service needs and preferences (by size and type of organization) and develop a plan to improve service to these organizations, followed by further research of the tax exempt sector, and that it "[d]edicate a group of employees, from both outreach and compliance functions, entirely to small EOs. Such entities have very different needs from mid-sized and large EOs and require a different approach."). *See also* National Taxpayer Advocate 2009 Annual Report to Congress 287, 299 (reiterating the recommendation that the IRS design and implement an exempt organization TAB in order to formulate a targeted outreach plan based on research).

CONCLUSION

By adopting Form 1023-EZ to address inventory backlogs, the IRS relinquished its power to effectively determine whether applicants qualify as IRC § 501(c)(3) organizations. The IRS's own analysis shows a significant discrepancy between the rate at which Form 1023-EZ filers obtain exempt status and the rate of approval when the IRS subjects their applications to a slight amount of scrutiny. TAS's review of Form 1023-EZ filers that obtained exempt status confirms there is a significant level of erroneous approvals. Rather than auditing its way out of the noncompliance it helped create, the IRS should reconsider its decision to use Form 1023-EZ in its present form.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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.
2. Revise Form 1023-EZ to require applicants to provide a description of their actual or planned activities and submit summary financial information such as past and projected revenues and expenses.
3. Make a determination only after reviewing the Form 1023-EZ application, the applicant's organizing documents, its description of actual or planned activities, and its financial information.
4. Where there is a deficiency in an organizing document, require an applicant to submit a copy of an amendment to its organizing document that corrects the deficiency and has been approved by the state, even where the documents are available online at no cost, before conferring 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

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage & Investment Division
Ken Corbin, Director, Return Integrity & Compliance Services

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF THE PROBLEM

In general, the IRS uses the Pre-Refund Wage Verification Program (hereinafter - Income Wage Verification or IWV) to temporarily freeze an individual's refund (also called "refund holds") 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.[2] 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. For example:

- TAS's analysis of the population of taxpayers filing for tax year (TY) 2014, whose returns the Electronic Fraud Detection System (EFDS) selected for review in 2015 (through October), 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 fiscal year (FY) 2015.[3]
- 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

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The National Taxpayer Advocate initially expressed concerns regarding the increase in Criminal Investigation (CI) control, or "freeze," by the IRS's CI Fraud Detection Units in her 2003 Annual Report to Congress. *See* National Taxpayer Advocate 2003 Annual Report to Congress 175 (Most Serious Problem: *Criminal Investigation Freezes*). This program preceded the current IWV Program operated by the IRS's Integrity & Verification Operation unit.

3 A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. IRS response to TAS information request (Oct. 20, 2015). The IRS did not track the false positive rates, also called detection rates, for EFDS. However, in FY 2015, it began tracking the false positive rate for EFDS related to the TPP.

(LOS) for taxpayers trying to contact the IRS to verify their identity plummeted. At one point during the peak of the filing season, only one out of ten calls got through to a live assistor.[4]

- 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.

The workload in the Integrity & Verification Operation (IVO) unit, which operates the IWV program, decreased by 47 percent in CY 2015. Yet TAS received 36,752 IWV cases in the first nine months of 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 and IWV holds, spending an average of 8.2 weeks to resolve these cases.[5]

The National Taxpayer Advocate acknowledges that any effective screening method will result in false positives, no matter how well designed. However, the high false positive rates in all of these programs are unnecessarily high; moreover, she 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;
- The IRS does not have adequate procedures to promptly review and adjust its fraud detection filters, rules, and models; and
- Taxpayers whose refunds are frozen by the IWV program cannot reach a live assistor in the 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 OF PROBLEM

Background

The return integrity program, a process critical to the IRS's strategy to address identity theft and detect and prevent improper fraudulent refunds, is complex and multifaceted.[6] The Return Integrity & Compliance Services (RICS) IVO — a part of the Wage & Investment (W&I) Division — uses filters, rules, data mining models, and manual reviews to identify potentially false returns, usually through wages or withholding reported on the returns, to stop fraudulent refunds before the IRS issues them.[7] It electronically screens tax returns using three independent systems: the Dependent Database (DDb), the RRP, and the EFDS. If one of the systems flags a return as potentially fraudulent, the return goes to the TPP or the IWV program. Figure 1.4.1 provides a simplified flow chart of the complicated processes IVO uses to screen returns claiming refunds.

4 See 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*.

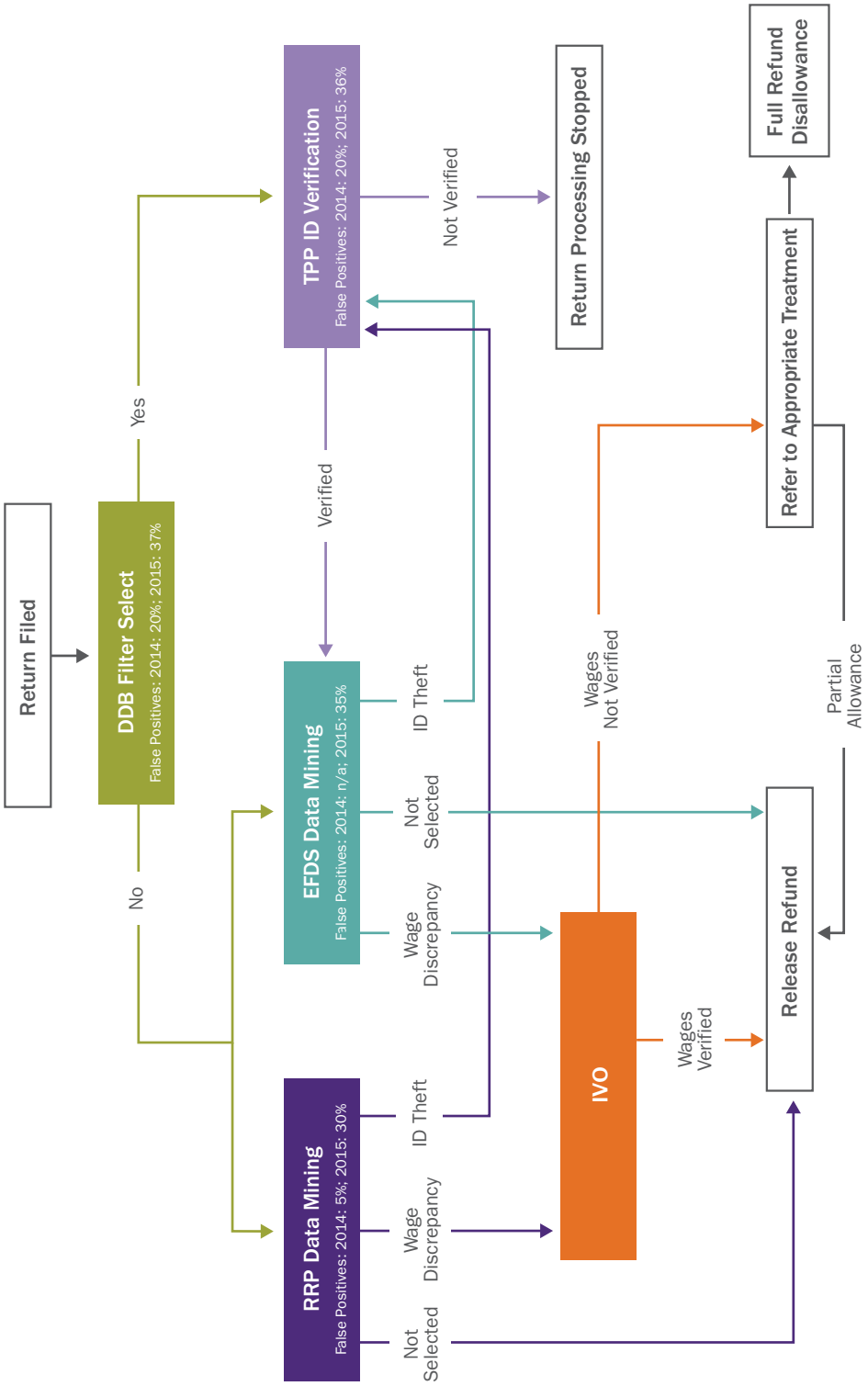
5 Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Oct. 6, 2015). Closed IVO refund holds cases through Sept. 30, 2015 were open an average of 58.33 days. TAS Case Assistance by Issue Code (CABIC) 045.

6 IRM 25.25.1.1 (Feb. 19, 2015).

7 IRM 25.25.2.1(1) (Aug. 20, 2015).

FIGURE 1.4.1

Flow Chart of Refund Return Processing in IVO



Taxpayer Protection Program

The TPP uses the DDb to look for returns that exhibit characteristics of identity theft. When it deems a taxpayer's return suspicious, the TPP freezes the return and advises the taxpayer via letter he or she must authenticate his or her identity by calling the TPP toll-free number or self-authenticate through the TPP's Out of Wallet website.[8] If the taxpayer is unable to authenticate, the IRS does not process his or her return, and the taxpayer may have to provide additional information, including a paper copy of the return filed.[9] In addition to the DDb, IRS analysts manually select returns using pattern-matching techniques to detect potential identity theft returns in mass batches. TPP has had a significant increase in its false positive rates, from 19.8 percent in CY 2014 to 36.2 percent in CY 2015 (year to date).[10] According to the IRS, the TPP stopped almost two million refunds in CY 2015, compared to almost 1.6 million refunds stopped in CY 2014.[11]

IWV Program

Next, the IRS processes returns claiming refunds, and it sends them through the EFDS. EFDS uses data mining models to score each Form W-2 and 1099 on refund returns for fraud potential based on business rules that consider return and filing characteristics.[12] For returns that score high enough on the EFDS, the IRS places an indicator on the account and delays posting for two weeks.[13] It sends potential identity theft returns back to the TPP and potentially fraudulent income/withholding returns to IVO for income verification. If the EFDS does not select returns, it posts and releases them for continued processing and does not include them in its false positive computation.[14]

When the IRS flags a refund return as having questionable income or withholding, it freezes the taxpayer's refund for a minimum of 11 weeks[15] while IVO employees attempt to contact the taxpayer's employers

8 IRM 25.25.6.1 (May 26, 2015). Out of Wallet questions are knowledge-based questions about private information not readily available that only the user will know.

9 IRM 25.25.6.5.1 (May 5, 2015).

10 *See* W&I Business Performance Review (May 15, 2015); IRS RICS, Update of the Taxpayer Protection Program (TPP) (Dec. 2, 2015).

11 Data obtained from IRS Global ID Theft Report (Sept. 30, 2015). The IRS stopped 1,987,714 refunds in year to date (YTD) 2015 and 1,593,457 cases in YTD 2014. For a full discussion of the National Taxpayer Advocate's concerns about identity theft, see 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.*

12 IRS response to TAS information request (Aug. 20, 2015). IRM 25.25.2.1 (Aug. 20, 2015).

13 The two-week hold allows IVO to screen the tax returns and look for fraud or potential identity theft issues.

14 Posting occurs when the tax return is posted to the customer account to reflect the filing of the return and includes tax computation to determine the tax obligation for this period.

15 IRM 25.25.2.4 (Aug. 20, 2015). The initial suspense period is ten days to allow for the IRS to send a letter to the taxpayer, which advises the taxpayer of the 60-day review period. The IRS sends Notice CP05, *Information Regarding Your Refund,* or Letter 4464C, *Questionable Refund 3rd Party Notification Letter. See* IRS response to TAS information request (Aug. 20, 2015). This 11-week "soft-hold" was negotiated by the National Taxpayer Advocate and the IRS post-2005 after the National Taxpayer Advocate showed in the 2005 Annual Report to Congress that the IRS was permanently freezing legitimate taxpayer refunds without reviewing them, resulting in an egregious abridgement of taxpayer rights and leading to the removal of the Questionable Refund Program (QRP) from CI to W&I, resulting in the creation of IVO. Although the initial hold is 11 weeks by default there are instances when a refund is released earlier. *See* National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*); National Taxpayer Advocate 2011 Annual Report to Congress 41 (Most Serious Problem: *The IRS's Wage and Withholding Verification Procedures May Encroach on Taxpayer Rights and Delay Refund Processing*).

to verify wages and withholdings reported.[16] If the employer verifies the information and IVO is satisfied the return is valid, the IRS will release the refund. If IVO cannot verify the return information through the Individual Master File (IMF) or employer contact, the IRS sends a letter to the taxpayer requesting documentation to substantiate the information.[17] It is unknown how long this process takes because the IRS does not track this information.[18] EFDS had a false positive rate of almost 35 percent in FY 2015 for returns the IRS sent to IVO for a determination.[19]

Return Review Program Models

The RRP application enhances the IRS's capabilities to detect, resolve, and prevent criminal and civil noncompliance, thereby reducing the issuance of fraudulent tax refunds.[20] RRP selects all potential issues related to identity theft or fraud on the return through initial processing and routes it to the proper treatment stream in pre-refund status. It then generates 15 scores that relate to the predictive value of possible identity theft or fraud.[21] The IRS planned for RRP to replace EFDS but is currently using both systems, which leads to more taxpayers experiencing refund delays because their refund returns have a higher chance of the filters stopping them. The Treasury Inspector General for Tax Administration (TIGTA) noted in a September 2015 report that the failure by the IRS to retire the EFDS program could result in an estimated $18.2 million in additional operation and maintenance costs. TIGTA recommended that the IRS retire EFDS, and the IRS agreed.[22] In FY 2014, the RRP false positive rate was five percent, which increased to 30.4 percent for FY 2015, an increase of over 500 percent.[23] One benefit of RRP over EFDS is that the IRS can adjust the RRP rules and models in real-time if systemic issues are identified, so improvements in this system will be essential to meet its objectives.

The IRS Does Not Track the False Positive Rates for the Pre-Refund Verification Program and Thus Is Unable to Determine What Stops Legitimate Refunds

As stated earlier, TAS considers any legitimate refund return that an IRS system selects and delays past the programs predetermined review period as false positive. The IRS fraud prevention units only track the false positive rates associated with identity theft. This includes programs such as TPP, EFDS, RRP, Manual Analyst, and DDb.[24] Somehow, the IRS has false positive data for TPP, EFDS, and RRP; however, false positive rates are not tracked for returns forwarded to the IWV program. False positive data, if monitored and analyzed in real-time, can be used by the IRS to improve its fraud prevention and IWV programs, minimize harm to taxpayers making legitimate refund claims, and preserve IRS resources.

16 IRM 25.25.3.1 (May 21, 2015). The IRS employs several methods to contact employers for verification of wages based on the information listed on the verification of income documents attached to the IMF returns, adhering to the employer preference if one exists. The IRS sends letters annually to certain large employers requesting they provide wage information on a computer disc. Requests for verification are automatically generated by fax; phone calls are made based on employer preference. The IRS employee makes three attempts to verify the information. IRS response to TAS information request (Aug. 20, 2015).

17 The IRS sends Notice CP05A, *Information Regarding Your Refund - Refund Being Held Pending More Thorough Review*.

18 IRS response to TAS information request (Aug. 20, 2015).

19 IRS response to TAS information request (Oct. 20, 2015). The IRS did not track the false positive rates for EFDS prior to FY 2015. However, in FY 2015, it began tracking the false positive rate for EFDS related to the TPP.

20 Privacy Impact Assessment (PIA) 1067 (Jan. 23, 2015), *available at* http://www.irs.gov/pub/irs-utl/RRP_TS_pia.pdf. A PIA is a process for examining the risks and ramifications of using information technology to collect, maintain, and disseminate information in identifiable forms about members of the public and agency employees.

21 *See* TIGTA, Ref. No. 2015-20-060, *The Return Review Program Enhances the Identification of Fraud; However, System Security Needs Improvement* (July 2, 2015).

22 *See* TIGTA, Ref. No. 2015-20-093, *Review of the Electronic Fraud Detection System* (Sept. 29, 2015).

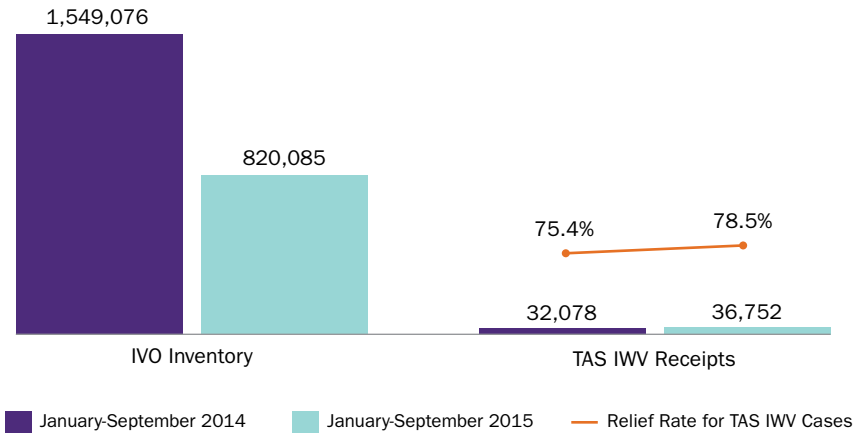
23 IRS response to TAS information request (Oct. 20, 2015).

24 IRS response to TAS information request (Aug. 20, 2015).

In 2015 (January through September), TAS provided full or partial relief in about 78.5 percent of cases closed for taxpayers who contacted TAS about delayed refunds flagged under the IWV Program. IWV cases constituted 19.3 percent of all TAS cases, or the second most common reason that taxpayers came to TAS for assistance.[25] TAS receipts of IWV cases have increased over 14.6 percent while the volume of the IRS's IWV holds has decreased over 47 percent, comparing the January through September periods from 2014 to 2015, as shown in Figure 1.4.2.[26]

FIGURE 1.4.2

TAS IWV Cases Increased Even Though IVO Inventory Decreased, January-September 2014-2015



The increase in the number of taxpayers seeking TAS assistance with IWV holds combined with the high relief rate of almost 80 percent is an indicator of serious problems with the IWV program. In other words, the IRS delayed, and, in some cases stopped, legitimate refunds to taxpayers because of over-inclusive filters or cross-competing rules.

Inexplicably, the IRS does not track the false positive rates for IWV holds, and thus is unable to determine what is causing the greater percentage of stopped legitimate refunds.[27] By applying findings from analysis of false positive returns, the IRS could prioritize identification of legitimate refunds at the earliest stage possible and develop better filters and models in real time.

Investing in tracking the IVO false positive rates by model or filter during the filing season, performing regular global reviews, and quickly adapting filters, rules, and models based on levels of confidence in each, would result in a more efficient utilization of resources and fewer delays for taxpayers with legitimate returns, thereby reducing taxpayer burden. The IRS should also establish target false positive rates for

25 Data obtained from TAMIS (Jan. 1, 2014; Oct. 1, 2014; Jan. 1, 2015; and Oct. 1, 2015).

26 *Id*. Data obtained from IRS Global ID Theft Report (Sept. 30, 2015). TAS received 32,078 cases in CY 2014 (January through September) and 36,752 cases in CY 2015. The IRS identified 1,549,076 cases in IVO for CY 2014 and 820,085 cases in CY 2015. This decrease in IRS IVO volume is significant because it may be an indicator that the IRS is not clearing cases in a timely manner.

27 IRS responses to TAS information requests (Aug. 20, 2015; Sept. 14, 2015). The IRS does track the false positive rates for TPP.

each process and filter in addition to creating a process to adjust selection rates so that the false positive rates do not exceed target level.

By applying findings from analysis of false positive returns, the IRS could prioritize identification of legitimate refunds at the earliest stage possible and develop better filters and models in real time.

In CY 2014, RICS adjusted its filters and rules, which increased returns in TPP, flagged for identity theft and decreased refund returns sent to the Pre-Refund Wage Verification Program.[28] These adjustments did not resolve the substantial delays of legitimate taxpayer refunds.[29] For example, taxpayers whose returns were flagged and sent to TPP experienced the worst LOS on the TPP phone line in recent history — at one point during the peak of the filing season the LOS was ten percent.[30] Moreover, the sequential processing of returns through various filters resulted in taxpayers being subjected to multiple reviews of the same return. Recent submissions to TAS's Systemic Advocacy Management System (SAMS) indicate the IRS cleared some returns from identity theft via TPP but then selected the same returns via the IWV program, which extended the refund hold resulting in unnecessary taxpayer callbacks.[31]

IVO Does Not Have Adequate Procedures to Promptly Review and Adjust Its Fraud Detection Filters, Rules, and Models

Recently Congress acted on the National Taxpayer Advocate's legislative recommendation to accelerate information reporting, and passed legislation requiring that returns and statements related to employee wage information and nonemployee compensation be filed on or before January 31.[32] The IRS should collaborate with TAS on implementing this legal requirement that will improve the screening and matching of third-party reporting with the information on taxpayers' returns.

Currently, IVO has no procedures or safeguards in place to promptly review and adjust its filters, rules, and models. For instance, the RRP erroneously flagged a group of returns and froze refunds that had previously cleared two systems and had historical data verifying their legitimacy.[33] At the time, RRP lacked access to the historical data and was unable to verify the results of prior screenings. Although the IRS can update RRP in real time, it needs approval from the Business Rules and Requirements Management

28 TAS believes that although the TPP is flagging more returns for identity theft, these refunds may still end up requiring wage verification treatment. The IRS is not flagging fewer returns overall in wage verification, rather it is flagging them with a different program.

29 Teleconference between the National Taxpayer Advocate and the RICS Director (Feb. 2, 2015). Discussion about the spike in IWV holds and the changing of TPP filters.

30 *See* 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.*

31 SAMS is a database of issues submitted to the TAS Office of Systemic Advocacy and the advocacy projects developed from some of these submissions. The issues come from a variety of sources. These include TAS, other IRS employees, and external stakeholders, including individual and business taxpayers, practitioners, research and professional organizations. *See* SAMS submission, Issue 32977 (May 18, 2015).

32 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 201 (2015). *See also* National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-8 (*Fundamental Changes: Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); 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*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*); National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the 'Pay Refunds First, Verify Eligibility Later' Approach to Tax Return Processing*).

33 SAMS submission 32694 (Mar. 26, 2015).

(BRRM) office.[34] BRRM does not meet regularly; therefore, any change request that needs immediate attention must go through a time-consuming approval process resulting in more refund delays. Creating a sub-approval group authorized to implement real-time modifications to screening rules and filters would allow a quicker resolution of systemic issues and minimization of taxpayer harm. The sub-group should include a TAS representative, since TAS often sees cases that are early-warning indicators of problems with filters.

At the end of FY 2012, the IRS eliminated the Pre-Refund Program Executive Steering Committee (ESC), leaving no overarching governance of the implementation of new filters, rules, and models or coordination of work involving multiple IRS functions. With the elimination of the ESC, the IRS cannot discuss problems associated with fraud detection data mining rules and filters at a servicewide level, resulting in additional delays for any necessary changes in screening rules and filters. In 2013, the National Taxpayer Advocate recommended that the IRS reinstate the ESC.[35] However, the IRS refused, stating, "The FY 2013 Return Integrity and Correspondence Service (RICS) reorganization established a centralized structure for the refund fraud program, and eliminated the need for an Executive Steering Committee (ESC)."[36]

If the IRS were to add staff to review returns on the front-end and answer taxpayer calls in the Integrity Verification Operation (IVO) unit, then more returns with legitimate refunds would be processed with fewer delays and less burden to the taxpayer, saving both the IRS and TAS resources from reworking these cases on the back-end.

The high rate of false positives in the IWV program in the absence of a forum to discuss potential flaws in filters and models suggests that the IRS's decision to eliminate the ESC was not well-founded. The IRS should reinstate the pre-refund program ESC as a forum for the exchange of information about systemic issues among IRS functions and for ideas about how to resolve these issues, as well as include TAS as a chartered voting member of the ESC.

Taxpayers Whose Refunds Are Frozen by the IWV Program Cannot Reach a Live Person in IVO

Unlike the TPP, IWV program does not have a dedicated phone number for taxpayers to call. As a result, taxpayers whose refunds are frozen face lengthy hold times and courtesy disconnects trying to reach IRS Customer Service representatives (CSRs) on a general line.[37] The CSR LOS for FY 2015 was 38.10 percent, compared to the FY 2014 LOS of 64.39 percent, representing a 40.8 percent decline.[38] If a taxpayer tries to get information from *Where's My Refund,* he or she will receive a generic message prompting a call to the IRS. Even if the taxpayer does reach a CSR, he or she will find the CSR

34 IRM 1.1.13.5.3.4 (Oct. 7, 2013). The office is responsible for the coordination and execution of the activities required to define, develop, maintain, and control business requirements and rules.

35 National Taxpayer Advocate 2013 Annual Report to Congress 173 (Most Serious Problem: *Revenue Protection: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds*).

36 Email from Chief of Staff, Office of the Commissioner of Internal Revenue (May 23, 2014) (on file with the National Taxpayer Advocate). Although the IRS does have a Revenue Protection Technology Governance Board which provides input and recommendations to the IRS Revenue Protection Technology ESC neither appear to have the overreaching governance and implementation power of the Pre-Refund Program Executive Steering Committee.

37 A courtesy disconnect is when the IRS phone line is overloaded and the caller is disconnected after a certain amount of time. For a full discussion of the National Taxpayer Advocate's concerns regarding taxpayer account access, 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*.

38 *See* IRS, Accounts Management (AM) (Sept. 30, 2015).

does not have access to the EFDS or RRP histories and cannot give specific responses to taxpayer inquiries.[39] CSRs take down information and route it to the IWV group in IVO. IVO, however, does not call back or correspond with a taxpayer based on referral from a CSR. If the information forwarded by the CSR is not verifiable, IVO will simply close out the referral on Account Management Services (AMS) application.[40]

Taxpayers Whose Refunds Are Frozen by the IWV Program Suffer From Delays and Inaction

Taxpayers with frozen refunds experience significant delays of 18 weeks on average while IVO employees attempt to verify wages and withholding.[41] TAS's analysis of the population of taxpayers filing for TY 2014, whose returns were selected by EFDS for review in 2015 (through October), showed that nearly 180,000 such taxpayers who finally received their refunds, experienced delays of nearly 18 weeks on average. Several examples illustrate the frustrations of taxpayers with legitimate refunds who were unable to reach a live assistor with access to their IVO accounts:[42]

- Taxpayers, who successfully authenticated their identity after their returns were stopped by the identity theft filters, were under the impression their refunds would be released. They were not notified by the IRS that there would be a second delay to their refunds, as their returns were then selected by the IWV program due to the IRS subsequently questioning reported wages and withholdings. A programming problem in IVO prevented the issuance of a Notice CP05, *Information Regarding Your Refund – We Have Received Your Income Tax Return and Are Holding Your Refund*. Multiple taxpayers contacted TAS after being unable to reach the IRS or to receive an explanation of the delay. TAS Office of Systemic Advocacy elevated this systemic issue, and the IRS committed to resolving this issue for the 2016 filing season.[43]
- In several instances, taxpayers were also subject to additional refund delays when IVO verified their wages and withholding but did not correctly input closing actions to release the refund. To release the refund, an employee must input the closing action into two separate IRS systems. If employees only input the action into one system, the IRS continues to hold the refund. IVO was not monitoring its inventory to ensure refunds were correctly and timely issued once verification took place. Taxpayers had to contact the IRS to inquire why they had not received their refund or request TAS assistance.
- In one instance, the IWV hold languished over a year without any contact from the IRS or action by IVO. It was only when an inquiry was referred to TAS that the hold was resolved in seven days.[44]

39 IRM 21.5.6.4.35.3 (Nov. 2, 2015).

40 IVO does not correspond with a taxpayer based on a referral from a CSR. To the contrary, if it is just a refund status inquiry not associated with any verifiable information, IVO employees will just close out the referral on AMS. IRM 25.25.5.2 (July 27, 2015); IRM 25.25.5.4 (July 27, 2015); IRM 25.25.5.4.1 (July 27, 2015).

41 "Significant delay" was quantified by TAS by analyzing the population of taxpayers filing for TY 2014 selected using EFDS for review in 2015. Through October, we found nearly 180,000 such taxpayers who finally received their refunds but were delayed on average nearly 18 weeks (median of 19 weeks). Additional taxpayers may still face delays, and future analysis will show how many taxpayers were affected and for how much longer. IRS CDW, TY 2014 filings received from January through October of 2015. Results quantify time elapsed between selection for review and receipt of refund (Dec. 2015).

42 These examples are compilation of facts from several SAMS submissions. SAMS issues 32694 (Mar. 26, 2015), 32900 (May 1, 2015), 33183 (July 9, 2015), and 33239 (July 22, 2015).

43 SAMS submission 32694 (Mar. 26, 2015).

44 SAMS submission 32900 (May 1, 2015), 33183 (July 9, 2015), and 33239 (July 22, 2015).

Even though IVO staffing has consistently increased, it appears the growth has not had a positive impact on the expedited screening and verification of the volume of cases the IVO program selects.[45] In CY 2015, the IRS selected 43 percent fewer returns for IWV, compared to CY 2014,[46] while the IVO staffing increased by over 12 percent from FY 2014 to FY 2015.[47] As stated above, IVO does not have a direct phone number for taxpayers to respond to IWV inquiries. Thus, the increase in staffing is not allocated to speeding up the verification process by accepting direct calls from affected taxpayers. Moreover, the increase in staffing did not result in a reduction of taxpayer burden as evidenced by the 14.6 percent increase in TAS cases during the same period.[48]

As stated earlier, the IRS has a period of time within which to look at a return before the grace period expires and the refund return is frozen for further review. If the IRS were to add staff to review returns on the front-end and answer taxpayer calls in the IVO unit, then more returns with legitimate refunds would be processed with fewer delays and less burden to the taxpayer, saving both the IRS and TAS resources from reworking these cases on the back-end. Implementing a front-end communication strategy, including live taxpayer assistance in the IVO unit, would reduce refund hold times and free more employees for further examination of fraudulent returns.

CONCLUSION

The National Taxpayer Advocate recognizes the importance of revenue protection screening techniques in protecting the tax system and the rights of taxpayers. Over the past 12 years, she has reported problems facing taxpayers whose legitimate refunds were frozen by the IRS and she has recommended improvements to reduce taxpayer burden while preventing refund fraud. Despite certain improvements, the IRS has not adopted several recommendations.[49] The IRS needs to balance its need to detect refund fraud with the taxpayers' *rights to be informed*, *to quality service*, *to privacy*, and *to fair and just tax system*.

45 IRS response to TAS information request (Oct. 20, 2015). For a full discussion of the National Taxpayer Advocate's concerns about third-party acceleration, see National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 67-96 (*Fundamental Changes: Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

46 IRS response to TAS information request (Oct. 20, 2015). In CY 2014, the IRS selected 1,925,671 items and the amount decreased in CY 2015 to 1,091,512 items selected. Even with the volume decrease, the IRS is still unable to manage the volume despite the increase in staff.

47 IRS response to TAS information request (Oct. 20, 2015). In FY 2014, the staffing level was 546, and in FY 2015 the staffing level was 612.

48 Data obtained from TAMIS (Jan. 1, 2014; Oct. 1, 2014, Jan. 1, 2015, and Oct. 1, 2015).

49 *See* National Taxpayer Advocate 2014 Annual Report to Congress 536 (*TAS Case Advocacy*); National Taxpayer Advocate FY 2015 Objectives Report to Congress 143-45 (*TAS Receipts Suggest the IRS Needs to Enhance Efforts to Detect and Prevent Refund Fraud*); National Taxpayer Advocate 2013 Annual Report to Congress 173 (Most Serious Problem: *Revenue Protection: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds*); 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*); National Taxpayer Advocate 2011 Annual Report to Congress 41 (Most Serious Problem: *The IRS's Wage and Withholding Verification Procedures May Encroach on Taxpayer Rights and Delay Refund Processing*); National Taxpayer Advocate 2006 Annual Report to Congress 408 (Status Update: *Major Improvements in the Questionable Refund Program and Some Continuing Concerns*); National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*); National Taxpayer Advocate 2003 Annual Report to Congress 175 (Most Serious Problem: *Criminal Investigation Freezes*).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Begin tracking the IVO 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 similar to the TPP.
2. Establish target false positive rates for each process and filter and create a process to adjust selection rates so that the false positive rates do not exceed target level.
3. 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.
4. 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.
5. 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; include a TAS representative as a member of this sub-committee.
6. 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

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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*

DEFINITION OF PROBLEM

The National Taxpayer Advocate has advocated for years that the Internal Revenue Service (IRS) develop an online account system for taxpayers.[2] In fact, the IRS is now planning an online account system and even identified taxpayer online account access as one of the key capabilities to achieve its compliance vision.[3] 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. Taxpayers with access to the system will be more informed about their tax accounts 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 system.[4] 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 access to the Internet. 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 may be tempting to move taxpayer service toward superficially lower-cost self-assistance options, any efforts to significantly reduce personal service

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 *See, e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

3 IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5 (July 28, 2015) (on file with the National Taxpayer Advocate).

4 As of May 2, 2015, approximately 83.2 million taxpayers contacted the IRS by calling the various Customer Account Services function toll-free telephone assistance lines. IRS assistors have answered approximately 8.3 million calls and provided a 37.6 percent Level of Service with a 23.5 minute Average Speed of Answer. Treasury Inspector General for Tax Administration, Ref. No. 2015-40-080, *Results of the 2015 Filing Season* 17 (Aug. 31, 2015).

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*.[5]

While in the current budget environment it may be 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*.

Research has shown individuals and businesses prefer multi-channel service delivery for government services. For example, a survey of German taxpayers showed that even those who ordinarily demand online services prefer to interact in person when they need more individualized services.[6] While the delivery of online services may appear cost-effective at first glance, focusing solely on one method of service delivery is short-sighted, because it does not properly address the actual service needs of taxpayers. Ignoring the service needs of a significant segment of the population will likely impact voluntary compliance and have far more costly downstream consequences for the IRS.

Finally, the National Taxpayer Advocate remains concerned about the scope of the self-correction authority set forth in the draft Concept of Operations (CONOPS). It is unclear whether the self-corrections could address adjustments made pursuant to the agency's math error authority or whether they will extend beyond math error so that they constitute an abbreviated audit.[7] More importantly, it is unclear if these corrections will constitute an amended return or if the original return remains unprocessed until corrected. All of these options have legal consequences to the taxpayer with potential negative impacts on taxpayer rights.

ANALYSIS OF PROBLEM

Background

The IRS's Enterprise CONOPS is a formal servicewide plan developed to define the future direction of the agency and identify the capabilities it needs to achieve this vision.[8] One of the main themes of the CONOPS is to empower taxpayers with the tools they need to facilitate compliance. In order to achieve this goal, the IRS has identified digital taxpayer account management and self-correction as key capabilities.[9] According to the IRS draft CONOPS, 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. 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.[10]

5 For a detailed discussion of the Taxpayer Bill of Rights, *see* http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights.

6 Julia Klier, Regina Pfleger & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, Wirtschaftsinformatik Proceedings 2015 180, 190 (2015), *available at* http://aisel.aisnet.org/cgi/viewcontent.cgi?article=1012&context=wi2015.

7 *See* IRC §§ 6213(b)(1),(g)(2).

8 *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, supra*.

9 IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5 (July 28, 2015) (on file with the National Taxpayer Advocate).

10 Draft IRS Compliance Concept of Operations (CONOPS) 3, 19-22 (June 8, 2014) (on file with TAS).

The IRS Cannot Drastically Reduce Both Face-to-Face and Telephone Services As It Focuses on Online Services Because Taxpayers Will Still Continue to Require Personal Services

Based on a 2014 survey, Forrester Research concluded that the public still uses non-digital channels more than digital ones. In fact, 37 percent of these survey participants indicated they do not trust the federal government to secure their personal data. Based on the survey findings, Forrester concluded that "[f]ederal agencies must act more strategically. They can win trust by perfecting existing [channels] before expanding and explaining the benefits of new channels as they roll out."[11] The recent security breaches pertaining to the IRS's "Get Transcript" online application and the Office of Personnel Management's (OPM) breach of federal employee records will only serve to undermine taxpayers' trust in communicating with the IRS and government online.[12]

Furthermore, additional research has shown individuals and businesses prefer multi-channel service delivery for government services.[13] Individuals prefer online services for information services, because they can gather and receive information or data on their own schedule and without a need for further discussion. However, they prefer to interact in-person when they need more individualized services. This multi-channel preference even exists for younger and well-educated individuals who typically have greater preferences for online services.[14] As for businesses, the medium to large companies prefer online services more than small businesses.[15]

It is not surprising that taxpayers continue to demand more personalized services considering the complexity of the tax law.[16] For those taxpayers comfortable using self-service options online, they must still struggle with understanding the substance of the tax law and how it applies to their unique circumstances. While the IRS official website is helpful and extensive, it currently has approximately 140,000 pages which can be overwhelming to taxpayers unfamiliar with the tax law.[17] Moreover, the website is not currently easy to navigate when using a mobile device, which could be a serious access issue for the increasing taxpayer population using smartphones.[18]

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11 Rick Parrish, Forrester Research, *Washington Must Work Harder to Spur the Public's Interest in Digital Government: Federal Agencies Are Spending Millions on Digital CX That Customers May Not Want* (Apr. 28, 2015) (in response to the survey question "In which of the following ways do you interact with US federal government agencies?" respondents chose the following digital methods: 41 percent indicated website, 16 percent indicated email, four percent chose Facebook, three percent chose mobile app, three percent chose online chat (text), two percent chose online chat (video), two percent chose Twitter, one percent chose Instagram, and one percent chose other social media. Respondents chose the following nondigital methods: 37 percent chose in person, 33 percent chose postal mail, and 32 percent chose phone).

12 IRS, IRS *Statement on the "Get Transcript" Application* (June 2, 2015); OPM, Announcements, *Information About the Recent Cybersecurity Incidents* (June 23, 2015).

13 As noted above, this was a survey of German taxpayers published in 2015. *See* Julia Klier, Regina Pfleger & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, Wirtschaftsinformatik Proceedings 2015, 180, 190 (2015), *available at* http://aisel.aisnet.org/cgi/viewcontent.cgi?article=1012&context=wi2015.

14 In fact, the 2013 Taxpayer Experience Survey conducted by IRS W&I Research and Analysis (WIRA) found that for all age categories of taxpayers (not just the elderly), only 34 percent felt secure sharing personal financial information over the Internet. IRS, W&I, *Use of Technology among Elderly and Low-income Taxpayers, Research Support for Fiscal Year (FY) 2015 Services Approach Efforts* 34 (May 2015).

15 Julia Klier, Regina Pfleger & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, Wirtschaftsinformatik Proceedings 2015, 180, 190 (2015), *available at* http://aisel.aisnet.org/cgi/viewcontent.cgi?article=1012&context=wi2015.

16 For a discussion of tax law complexity, see National Taxpayer Advocate 2012 Annual Report to Congress 3-23.

17 Information provided from IRS Office of Online Services, Online Engagement, Operations and Media (Sept. 25, 2015).

18 Aaron Smith, Pew Research Center, *U.S. Smartphone Use in 2015* 1 (April 1, 2015).

The IRS can partially address the demand for more individualized service by offering personalized digital services, such as live chat. Live chat has been found to successfully meet the needs of those who need immediate answers to simple questions.[19] However, a recent survey found demand for live chat falls short of demand for telephone services when addressing complex financial questions.[20]

The IRS Must Balance the Added Convenience of Expanding Online Services Against the Inherent Security Risks

The IRS is planning to expand its online service offerings to include more convenient methods for taxpayers to interact with the tax agency.[21] However, there is a risk involved in expanding online services, given the sensitive nature of the information entrusted with the IRS. The recent unauthorized access by cybercriminals of the IRS's "Get Transcript" application and resulting theft of the confidential tax return information of more than three hundred thousand taxpayers highlights the importance of cybersecurity considerations.[22] The OPM announcement earlier in the year concerning the hacking of its database, making vulnerable the personal information, and in some cases the fingerprints, of an estimated 21.5 million current and former federal employees, applicants, and their families has further undermined public trust in government online applications.[23] The continuing discovery of the depth of the breach will likely erode taxpayer confidence in using online services offered by the government.

Individuals prefer online services for information services, because they can gather and receive information or data on their own schedule and without a need for further discussion. However, they prefer to interact in-person when they need more individualized services.

In the wake of these recent cybersecurity breaches, the IRS should take time to investigate how taxpayers will respond to the necessary cybersecurity-related barriers to entry. Most taxpayers are fully aware that IRS systems contain extremely confidential tax return information and may be willing to tolerate extra security measures to access their accounts. In fact, the IRS has one of the most important and valuable stores of information in the world. Because the information it stores is a major asset of the United States and the stakes are high if the system is compromised, the IRS needs to take significant measures to protect its data. However, it is unclear at what point taxpayers decide the extra security precautions are too burdensome and avoid online account access as a result.

Further, the IRS should conduct a biennial nationwide survey of taxpayers to gauge what specific types of transactions or other activities they would be willing to conduct with the IRS digitally. By conducting the survey every other year, the IRS will have the ability to identify trends in IRS-specific digital needs and respond accordingly. In addition, the survey should include oversamples of low

19 The IRS has researched taxpayer demand for a potential secure online chat feature or "live chat" and a 2014 IRS study shows that taxpayers are interested in using this feature for the following transactions: submitting documentation, obtaining the status of a case, and discussing case details. IRS, WIRA, *Compliance TDC Conjoint: Findings and Recommendations* (Sept. 2014).

20 A survey conducted by Software Advice found 74 percent of respondents prefer telephone for complex financial questions. Craig Borowski, *The Impact of Demographics on Live Chat Customer Service*, Software Advice (Jan. 6, 2015).

21 IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5 (July 28, 2015) (on file with the National Taxpayer Advocate).

22 IRS, *Additional IRS Statement on the "Get Transcript" Incident* (Aug. 17, 2015).

23 OPM Statement, *Statement by OPM Press Secretary Sam Schumach on Background Investigations Incident* (Sept. 23, 2015); Devlin Barrett and Damian Paletta, *Officials Masked Severity of Hack*, Wall St. J., June 24, 2015, *available at* http://www.wsj.com/articles/hack-defined-as-two-distinct-breaches-1435158334; Ellen Nakashima, *Chinese Breach Data of 4 Million Federal Workers*, Wash. Post, June 4, 2015, *available at* http://www.washingtonpost.com/world/national-security/chinese-hackers-breach-federal-governments-personnel-office/2015/06/04/889c0e52-0af7-11e5-95fd-d580f1c5d44e_story.html.

income, Spanish-speaking and small business taxpayers to ensure that the IRS tracks the needs of these populations.[24]

Comprehensive Studies Demonstrate Low Income and Other Vulnerable Taxpayer Populations Need Person-to-Person Assistance to Comply with Their Federal Tax Obligations

In 2014, TAS, which oversees and administers the Low Income Taxpayer Clinic (LITC) grant program for the IRS,[25] commissioned a survey by Russell Research to better understand the needs and circumstances of taxpayers eligible to use the clinics. The survey found 15 percent of LITC-eligible taxpayers reported receiving notices from the IRS. In response, 55 percent called the IRS, 29 percent replied by letter, 24 percent contacted their preparers, and nearly 20 percent did nothing (the survey allowed more than one response).[26]

Further, Pew Research Center periodically conducts surveys to determine Internet usage by American adults. While the survey results clearly show a steady rise in Internet usage among all populations, some populations adopt at a slower pace than others. Significant percentages of certain populations still fall behind and will need to use methods that do not involve Internet usage to interact with the IRS. The following figure shows categories of taxpayers with lower Internet usage rates, as of May 2015:[27]

FIGURE 1.5.1, 2015 Pew Research Center Survey Results of Internet Use Among Different Categories of Taxpayers

Category	Percent
Overall American adult population	84%
Age: American adults 65+	58%
Education Attainment: Less than high school degree	66%
Household Income: Less than $30,000	74%
Race or Ethnicity: African Americans	78%
Race or Ethnicity: Hispanics	81%
Community Type: Rural	78%

24 This recommended survey is envisioned to be more comprehensive than the Compliance TDC Conjoint study conducted by the IRS in 2014. It should specifically address the reasons why taxpayers would or would not use a particular service channel for each type of transaction conducted with the IRS, with a particular focus on low income and small business taxpayers. IRS, WIRA, *Compliance TDC Conjoint: Findings and Recommendations* (Sept. 2014). "Low income taxpayer" is generally defined as a taxpayer who has a household income that does not exceed 250% of the federal poverty level (FPL), based on the annual poverty guidelines published by the Department of Health and Human Services.

25 The IRS awards matching grants to organizations that provide representation to low income individuals who need help resolving tax problems with the IRS. *See* IRC § 7526. At least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the federal poverty level. *See* IRC § 7526(b)(1)(B)(i). The U.S. Department of Health and Human Services publishes yearly poverty guidelines in the Federal Register, which the IRS uses to establish the 250 percent threshold for LITC representation. For the 2015 poverty guidelines, see 80 F.R. 3236-3237 (Jan. 22, 2015).

26 This Random-Digit Dialed (RDD) telephone survey utilized both cell phone numbers and landline numbers to reach participants. This approach was used to make sure all groups of the LITC-eligible taxpayers were represented in the survey. The survey included more than 1,100 individuals and gathered information on eligible taxpayers' awareness and use of LITC services, the types of issues for which they would consider using clinic services, and other items including demographic information. *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*).

27 Andrew Perrin and Maeve Duggan, Pew Research Center, *Americans' Internet Access: 2000–2015* (June 26, 2015).

A 2015 online survey by Forrester Research explored the use of certain devices to conduct various transactions online. While this study was conducted online and thus excluded responses from offline individuals or those with limited online capabilities, it produced some noteworthy findings:[28]

- On average, only 19 percent of adults search for government services and policies with a personal computer or laptop. This rate drops to 11 percent when using personal tablets and to seven percent when using a mobile phone.
- With few exceptions, those in lower income brackets used all devices to conduct online financial transactions less frequently than the national average.
- On average, 22 percent of adults use their mobile phones to check financial statements. Only 16 percent use their mobile phones to pay bills and 16 percent used their mobile phones to transfer money between accounts.

In fiscal year (FY) 2015, the Wage and Investment (W&I) Operating Division compiled existing research on American technology usage to determine the impact reductions in the Taxpayer Assistance Center (TAC) budget and IRS printed forms and publications would have on the elderly, low income, and rural communities.[29] The research found that, while each community saw a steady increase in Internet usage, these communities had lower computer ownership and Internet usage rates. Interestingly, the research also found that southern states are more likely to have lower percentage of households that own a computer. The research emphasized that offline taxpayers are equally as likely to access face-to-face services at TACs as they are to use irs.gov, and that they are more likely to use the IRS toll-free line compared to TACs and irs.gov.[30] The research also noted that the 2013 Taxpayer Experience Survey conducted by IRS W&I Research and Analysis (WIRA) found that for all age categories of taxpayers (not just the elderly), only 34 percent of taxpayers felt secure sharing personal financial information over the Internet.[31]

While the IRS official website is helpful and extensive, it currently has approximately 140,000 pages which can be overwhelming to taxpayers unfamiliar with the tax law. Moreover, the website is not currently easy to navigate when using a mobile device, which could be a serious access issue for the increasing taxpayer population using smartphones.

Finally, the IRS conducted a survey in 2014 to determine taxpayer usage of existing service channels as well as planned future service channels for different types of transactions. The findings showed migration for each type of transaction toward future service channels, including secure message, secure online chat, the online account program, smartphone applications, and automatic email or text notifications. However, the results showed that some taxpayers prefer to stay with existing service channels. The following figure illustrates the percentages of taxpayers who would prefer to use existing service channels, when compared with a potential future state service configuration, by type of transaction.[32]

28 Because this survey was conducted online, the reported usage rates may be higher than for the general population. Forrester Research, *North American Consumer Technographics Online Benchmark Survey*, Part 1 (2015) (on file with TAS).

29 IRS, Wage & Investment, *Use of Technology among Elderly and Low-income Taxpayers, Research Support for Fiscal Year (FY) 2015 Services Approach Efforts* (May 2015).

30 *Id*. at 23.

31 *Id*. at 13.

32 IRS, W&I Research & Analysis, *Compliance TDC Conjoint: Findings and Recommendations* (Sept. 2014).

FIGURE 1.5.2, Percentage of Taxpayers Choosing to Remain with Existing Service Channels Despite the Introduction of New Channels, By Type of Transaction

Type of Transaction	Percentage of Taxpayers Choosing to Stay With Existing Service Channel
Status of Case	Phone (Customer Service Representative (CSR)): 11%
Sign a Document	Phone (CSR): 13% Fax: 15% Regular Mail: 16%
Discuss Case Details	Phone (CSR): 43% Regular Mail: 15%
Request an Extension	Phone (CSR): 30% Regular Mail: 23%

The LITC-eligible taxpayer survey, the Pew and Forrester findings, as well as the IRS's own research support the need for the IRS to design a taxpayer service strategy based on the actual requirements of the taxpayer population rather than focusing on initially attractive but ultimately short-term resource savings. The survey findings and studies show a significant portion of taxpayers may not use online or self-assistance services. While online self-help tools certainly have significant benefits in that they address the needs of an increasing portion of the population in a lower-cost manner, the IRS is harming offline taxpayers when it significantly decreases the face-to-face and person-to-person telephone services. The IRS has already begun to reduce the amount of full-time equivalent employee (FTE) resources to the phones and to the TACs. Figure 1.5.3 illustrates the budgeted FTE for both types of services between FY 2013 to FY 2015.[33]

FIGURE 1.5.3, W&I Full-Time Equivalent Employee Expenditures for Toll-Free and Field Assistance

	FY 2013	FY 2014	FY 2015	FYs 2013 to 2015 % Change
Toll-Free	7,726	6,915	4,591	-40.6%
Field Assistance	1,892	1,927	1,868	-1.3%

Questions Remain Concerning the Legal Implications of Self-Correction Authority

The National Taxpayer Advocate remains concerned about the scope of the self-correction authority set forth in the draft CONOPS. For example, it is unclear whether the self-corrections could address adjustments made pursuant to the agency's math error authority or whether they will extend beyond math error so that they constitute an abbreviated audit.[34] More importantly, it is unclear what these corrections will constitute. If the taxpayer corrects the return pursuant to the new self-correction authority, will the correction constitute an amended return or is the return still an original return that the IRS has not yet completely processed? All of these possible options have legal consequences to the taxpayer and all have potential negative impacts on taxpayer rights.

33 IRS, W&I Division response to TAS information request (Sept. 22, 2015) (Field Assistance numbers include management and headquarters; for FY 2015, Field Assistance FTE is projected and Toll-free is through Aug. 15, 2015).

34 The IRS is currently authorized to correct mathematical or clerical errors — arithmetic mistakes and the like — and assess any tax increase using summary assessment procedures that do not provide the taxpayer an opportunity to challenge the proposed deficiency in the United States Tax Court before the tax is assessed. See IRC §§ 6213(b)(1),(g)(2). Consequently, the use of math error bypasses critical procedural taxpayer rights protections.

Even more disturbing is the Administration's proposed legislation to give the IRS more flexibility to address "correctable errors" (by regulation); this new category of "correctable errors" would give the IRS the authority to make adjustments not covered by existing math error authority.[35] It is unclear if the IRS will give preparers and third parties the authority to address these correctable errors.[36] The National Taxpayer Advocate will seek a Counsel opinion to determine the boundaries and corresponding legal implications of such authority.

CONCLUSION

As the IRS migrates toward more digital interactions with the taxpayers, it is essential that it continues to offer personal services to those taxpayers who either (1) do not have the ability to use digital services, (2) have a strong preference to conduct certain transactions by phone or face-to-face, or (3) have an issue that is not conducive for resolution through digital means. The various studies discussed herein show that a significant segment of the taxpayer base may not be ready to interact with the IRS digitally. Furthermore, recent cybersecurity attacks on both IRS applications and OPM databases highlight the need to balance security risks with any online benefits applicable to both taxpayers and the IRS.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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. The survey should include oversamples of low income, Spanish-speaking, and small business taxpayers to ensure that the IRS tracks their needs.
2. Conduct research to identify the taxpayer base who will utilize the online taxpayer account system as well as other online service offerings. For those taxpayers likely to use the online services, the research should break it down by specific types of transaction or interaction with the IRS. Further, if a taxpayer has indicated that he or she will not use the program, the research should address the reasons for not using the program.
3. 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. Such plan should take into account the reasons for the taxpayer's behavior and potentially tailor the personal services to meet those needs.
4. Research taxpayer response to the necessary online account system cybersecurity and authentication measures to determine the percentage of taxpayers who decide the necessary barriers to entry are too burdensome and avoid online account access as a result.

35 The proposed correctable error authority would enable the IRS to assess tax without using the deficiency procedures in the following situations: (1) the information provided by the taxpayer does not match the information in government databases; (2) the taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or (3) the taxpayer has failed to include with his or her return documentation required by statute. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* 245-46 (Feb. 2015), *available at* http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

36 For more detail on the National Taxpayer Advocate's position on the proposed correctable error legislation, see *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. 34-35 (2015) (written testimony of Nina E. Olson, National Taxpayer Advocate).

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

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TAXPAYER RIGHTS IMPACTED[1]

- *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 Confidentiality*

DEFINITION OF PROBLEM

The National Taxpayer Advocate has advocated for years that the IRS develop an online account system for taxpayers.[2] A recent draft of the IRS Compliance Concept of Operations (CONOPS) identified online account access as one of the top ten initatives needed to achieve its compliance vision.[3] Pursuant to the draft CONOPS, 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.[4] Accordingly, the National Taxpayer Advocate has the following concerns regarding preparer access to taxpayers' online accounts:

- Only preparers who are subject to IRS oversight should have access to taxpayers' online accounts;
- The IRS should clearly define the scope of preparers' access to online accounts;

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); 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, supra*.

3 IRS, *IRS Enterprise Concept of Operations (CONOPS): Overview of SB/SE and W&I, LB&I, and TE/GE CONOPS 25* (Jan. 15, 2015); *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*, *supra*.

4 IRS, *Compliance Capabilities Initiative: Draft Blueprint for the Vision* 10-2, 21-30 (June 19, 2014); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-2 (July 28, 2015) (on file with the National Taxpayer Advocate).

- The online account system should enable the taxpayer to maintain strict control over preparer authorizations, including approved actions; and
- The IRS should develop and implement procedures to ensure that preparers do not exceed their authority when accessing taxpayers' online accounts.

We are also concerned that the IRS plans to expand the third-party designee authorization on Form 1040 to include e-file software providers and Electronic Return Originators (EROs). By checking off the box, taxpayers would give these entities broad authorizations to perform actions that are likely beyond what most taxpayers realize.

ANALYSIS OF PROBLEM

Background

A recent draft of the IRS Compliance CONOPS envisions that the IRS will develop an online account system that enables taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates. It will also enable those taxpayers and authorized preparers to perform "self-correction" functions such as verifying return changes the IRS made, updating or amending returns, and providing additional documents.[5]

The IRS Should Permit Online Account Access to Only Preparers Subject to IRS Oversight

The IRS currently plans to enable the taxpayer to maintain control over whom can gain access to the account.[6] However, the IRS does not have any plans currently in development to restrict preparer access to the online account system by type of preparer. The National Taxpayer Advocate is concerned that the IRS will expose taxpayers to potential harm due to preparer incompetence or misconduct if it does not restrict access to only those preparers subject to IRS oversight pursuant to Circular 230.[7]

Preparers subject to IRS oversight under Circular 230 include attorneys, certified public accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents.[8] In addition, pursuant to Revenue Procedure 2014-42, preparers who have obtained the voluntary Annual Filing Season Program (AFSP) Record of Completion can represent taxpayers before the IRS during an examination of a tax return or claim for refund they prepared. Preparers can voluntarily obtain an AFSP Record of Completion each calendar year if they successfully complete 18 hours of continuing education (CE) from IRS-approved CE providers, which includes a six-hour Annual Federal Tax Refresher (AFTR) course, obtain a score of at least 70 percent in the associated AFTR examination,[9] and agree to be subject to the duties and restrictions relating to practice before the IRS in Subpart B and § 10.51 of Circular 230 for the entire period covered by the AFSP Record of Completion.[10] After December 31, 2015, the IRS will no longer allow non-credentialed preparers without the AFSP Record of Completion to engage in limited practice on

5 IRS, *IRS Enterprise Concept of Operations (CONOPS): Overview of SB/SE and W&I, LB&I, and TE/GE CONOPS* 25 (Jan. 15, 2015); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-12 (July 28, 2015) (on file with the National Taxpayer Advocate).

6 IRS, *Compliance Capabilities Initiative: Draft Blueprint for the Vision* 19 (June 19, 2014); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-2 (July 28, 2015) (on file with the National Taxpayer Advocate).

7 31 U.S.C.§ 10.3.

8 *Id*.

9 Rev. Proc. 2014–42, § 4.05(2)(a), I.R.B. 2014-29 (July 14, 2014).

10 *Id*.

If the IRS does not limit online account access to only preparers subject to Circular 230 oversight, it could harm taxpayers and consequently, increase compliance issues.

returns they prepare after that date. Accordingly, the National Taxpayer Advocate believes that the IRS should restrict access to the online account to only preparers subject to Circular 230 oversight. As set forth below, the IRS has the ability to monitor and enforce this requirement because it has preparer tax identification numbers (PTINs) for these individuals. If the IRS does not limit online account access to only preparers subject to Circular 230 oversight, it could harm taxpayers and consequently, increase compliance issues. Without instituting safeguards on access to the system, the IRS could inadvertently facilitate or perpetuate preparer misconduct. Uncredentialed preparers could gain access, interact with the IRS on the taxpayer's behalf, and potentially address notices, proposed adjustments, or even proposed correctable errors without the taxpayer's consent or knowledge.[11] Although the vast majority of return preparers are conscientious and ethical, the IRS has ample evidence and experience to show that there are some return preparers who are committing refund fraud[12] or are negligent, and that certain payroll service providers who have access to employer accounts also embezzle funds and cover their tracks by changing account information.[13]

Further, in 2014, TAS commissioned a survey by Russell Research to better understand the needs and circumstances of taxpayers eligible to use the low income taxpayer clinics (LITCs).[14] The survey findings raise fundamental questions about the appropriateness of relying on preparers as intermediaries for the low income population, especially the Spanish speakers in this category, and particularly with the unregulated return preparer population. Nearly half of all LITC-eligible taxpayers used return preparers, as did approximately 75 percent of Spanish-speaking eligible taxpayers. However, the survey participants reported that a significant percentage of these preparers did not satisfy the very basic statutory requirements

11 For more detail on the National Taxpayer Advocate's position on the proposed correctable error legislation, see *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. 34-5 (2015) (written testimony of Nina E. Olson, National Taxpayer Advocate).

12 *Id.*; *see* National Taxpayer Advocate 2014 Annual Report to Congress 543-44; National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-8; and National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing Its Efforts to Effectively Regulate Return Preparers*).

13 *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the H.R. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. 20-3 (Apr. 15, 2015) (written testimony of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2014 Annual Report to Congress 218-24 (Most Serious Problem: *Offers in Compromise: The IRS Needs to Do More to Comply With the Law Regarding Victims of Payroll Service Provider Failures*); National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 337-54 (Most Serious Problem: *Third Party Payers*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

14 Russell Research, *Topline Findings from a Taxpayer Advocate Service Survey of Taxpayers Who Are Eligible to Use IRS's Low Income Taxpayer Clinics (LITC)* 5 (July 2014). TAS oversees and administers the LITC grant program for the IRS. The IRS awards matching grants to organizations that provide representation to low income individuals who need help resolving tax problems with the IRS. *See* IRC § 7526. At least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the federal poverty level. *See* IRC § 7526(b)(1)(B)(i). The U.S. Department of Health and Human Services publishes yearly poverty guidelines in the *Federal Register*, which the IRS uses to establish the 250 percent threshold for LITC representation. For the 2015 poverty guidelines, see 80 Fed. Reg. 3236-3237 (Jan. 22, 2015).

under IRC §§ 6695(a) and (b).[15] For example, the participants reported that the preparer did not sign the return or did not give the taxpayer a copy more than 15 percent of the time. This percentage rose to more than 30 percent for Spanish-speaking eligible taxpayers.[16] Accordingly, TAS will continue to advocate to protect taxpayers from any harm imposed by giving third parties access to taxpayers' online accounts.

The IRS Should Clearly Define the Scope of Preparers' Access to Online Accounts

The IRS has not yet defined exactly what a preparer can do on behalf of the taxpayer upon gaining access to the taxpayer's online account. According to the CONOPS, preparers would be able to securely interact with the IRS to obtain return information, submit payments, and receive status updates. Authorized preparers would also be able to perform "self-correction" functions such as verifying return changes made by the IRS, updating or amending returns, and providing additional documents.[17] TAS remains concerned about the scope of this self-correction authority. For example, it is unclear whether these self-correction actions could include addressing adjustments made pursuant to the agency's math error authority.[18] Of particular concern is the planned ability of preparers to verify return changes made by the IRS as well as update or amend returns on behalf of the taxpayer, especially if the IRS does not limit access only to those preparers subject to IRS oversight.

Without any restrictions on type of preparer, there is a greater chance that vulnerable taxpayers could be harmed by preparers who prey upon the elderly, low income, and taxpayers with disabilities. Consider the possibility that preparers will develop a boilerplate form for the taxpayer to sign to authorize the preparer to conduct the above-referenced actions. If the preparer either fraudulently or negligently prepares an inaccurate return, the IRS may have just given the preparer the ability to cover his or her tracks. It is also possible that the taxpayer will not become aware of the problem for a long time. Finally, the preparer's actions could severely prejudice the taxpayer's procedural rights. For example, if the preparer accepts math error adjustments without the taxpayer's knowledge, the taxpayer may lose the right to contest the change in the U.S. Tax Court.[19]

The Online Account System Should Enable the Taxpayer to Maintain Strict Control Over Preparer Authorizations

TAS believes that the IRS should give the taxpayer strict and detailed control over preparer authorizations and develop procedures for the taxpayer to fine-tune them on the online account. While some

15 IRC § 6695(a) imposes a penalty on a tax return preparer for failure to provide a copy of the return to the taxpayer, unless the failure is due to reasonable cause and not to willful neglect. IRC § 6695(b) imposes a penalty on a tax return preparer for failure to sign a return when required by regulation to do so, unless the failure is due to reasonable cause and not to willful neglect.

16 Russell Research, *Topline Findings from a Taxpayer Advocate Service Survey of Taxpayers Who Are Eligible to Use IRS's Low Income Taxpayer Clinics (LITC)* 5 (July 2014). For more information on the LITC-eligible taxpayer study, see National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help From the Clinics*).

17 IRS, *IRS Enterprise Concept of Operations (CONOPS): Overview of SB/SE and W&I, LB&I, and TE/GE CONOPS* 25 (Jan. 15, 2015); IRS, *Compliance Capabilities Initiative: Draft Blueprint for the Vision* 10-2, 21-30 (June 19, 2014); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-2 (July 28, 2015) (on file with the National Taxpayer Advocate).

18 The National Taxpayer Advocate has written extensively about her various concerns regarding the expansion of math error authority under IRC § 6213(g). *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163-71 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*).

19 IRC § 6213(b)(1) provides that a taxpayer has no right to petition the Tax Court upon receiving a math error notice. IRM 21.5.4.1, *General Math Error Procedures Overview* (Oct. 1, 2014). In math or clerical error cases, the service may assess and send a notice of assessment of additional tax without using deficiency procedures.

taxpayers may not have close relationships with their preparers, others have long-term relationships and completely trust their preparer to interact with the IRS on their behalf. A taxpayer can decide the limits of the authority he or she wants to convey to a preparer but must avoid signing boilerplate forms giving the preparer broad access to the online account system with minimal restrictions. The IRS should bring IRS Form 2848, *Power of Attorney and Declaration of Representative*, into the 21st century by building the online account system to provide specific checkboxes addressing authorizations for each type of action a preparer could take on behalf of the taxpayer on the online account system. For example, the checkboxes could include some of the following actions:[20]

- Provide the IRS any information that is missing from the taxpayer's return;
- Obtain from the IRS information about the processing of the taxpayer's return or the status of the taxpayer's refund or payment(s);
- Receive copies of notices or transcripts related to the taxpayer's return, upon request; and
- Respond to certain IRS notices about math errors, offsets, and return preparation.

TAS believes that the IRS should give the taxpayer strict and detailed control over preparer authorizations and develop procedures for the taxpayer to fine-tune them on the online account.

These proposed checkboxes are also relevant to the current plans of the IRS to expand the third-party designee authorization on Form 1040 to include e-file software providers and EROs. By checking off one box, the taxpayer would give the software provider or ERO, whichever is applicable, the blanket authority to perform any or all of the actions included in the four bullets above. The rationale for this expansion is to enable the parties to obtain refund status information from the IRS, so that they can inform the taxpayer and subsequently, the IRS will receive fewer calls from the taxpayers seeking this information. However, there is no reason the software provider or ERO should have the authority to perform all of the actions listed. In fact, the taxpayer, if given the choice, probably would not agree to provide the authority to these parties to perform most of the actions listed.

The IRS Should Develop and Implement Procedures to Track Preparer Access and Restrict Unauthorized Activities

Once the taxpayer specifies the preparer's authorities for the online account system, the IRS must develop a method to track preparer access and restrict all unauthorized activities. The IRS should build the system to prevent unauthorized activities from happening in the first place. As discussed above, the system should first restrict access to only those preparers subject to IRS oversight pursuant to Circular 230. It also should build the online account system so it validates the preparer's PTIN information. If the system determines the preparer is unregulated and did not take part in the voluntary AFSP, then it could automatically block certain authorization checkboxes. The checkboxes ensure that everyone involved in a transaction knows exactly what the taxpayer has authorized the preparer to do.

Under agency law, the preparer is acting as the taxpayer's agent. Accordingly, pursuant to the Doctrine of Apparent Authority (sometimes referred to as the Doctrine of Ostensible Authority), any reasonable third party is allowed to rely on the agent's actions, unless the third party has reason to know that the agent's

20 The four bullets listed are the actions for which the taxpayer designates a third party after Line 79 of tax year 2014 Form 1040, *U.S. Individual Income Tax Return*. IRS Form 1040 Instructions 2014. However, ideally, the check boxes should have plain language explanations that have been reviewed by members of the Taxpayer Advocacy Panel (TAP) and LITCs, who have experience communicating with vulnerable populations and also represent them in situations where preparers have taken unauthorized actions.

actions are unauthorized. Therefore, the IRS is allowed to rely on the preparer's actions, unless it has reason to know that the taxpayer did not grant the preparer authority to conduct certain transactions. In fact, under agency law and the Doctrine of Apparent Authority, the taxpayer may be liable for any of the preparer's unauthorized actions if he or she granted a blanket authorization on the online account system, even if the taxpayer had an agreement with the preparer to conduct only one specific type of transaction.[21] The taxpayer would then have to seek recourse against the preparer and may be left to correct those errors, made by the preparer's unauthorized transaction conducted by the preparer, on his or her own.

The Doctrine of Apparent Authority assumes that the third party, the IRS, did not have reason to know that the agent, the preparer, was conducting an unauthorized action. However, the significant occurrence of return preparer fraud may be enough to give the IRS reason to know or appreciate the potential risk for unauthorized actions by unscrupulous preparers.[22] Therefore, there is a possibility that the taxpayer will not be liable for the unauthorized actions of the preparer if the IRS has reason to know of the potential risk. Further, if the IRS creates the online account system with blanket authorizations as the only available option, the IRS may have difficulty holding the taxpayer liable because it is not making an effort to protect its interests by mitigating the known risk of unauthorized actions.[23] The IRS should give serious consideration to this issue as it develops the process for taxpayer authorizations on the system.

Because the taxpayer may be held 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.

Because the taxpayer may be held 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. Therefore, whenever a preparer takes any type of action on the online account system, including merely accessing the account, the system should alert the taxpayer, in a manner specified by the taxpayer, such as by email or text. Though TAS anticipates IRS hesitation to bombard the taxpayer with messages from the system, it believes the taxpayer needs to know when the preparer accesses the system and exactly what type of transaction the preparer conducted. If the taxpayer feels uncomfortable with the action taken, he or she should then have the ability to report a grievance based on information provided in each system alert communication. Most importantly, this alert system would provide notice to the taxpayer of unauthorized actions and enable the taxpayer to take immediate steps to undo them.

In addition, if the system does not prevent unauthorized actions, the IRS could violate IRC § 6103 if it inappropriately discloses taxpayer information to an unauthorized preparer accessing the system. Unauthorized access also infringes upon the taxpayer's *right to confidentiality*.[24] While the IRC provides civil and criminal penalties for inappropriate uses and disclosures by preparers of tax return information, the IRS should issue guidance specifically applying the provisions to unauthorized access to the online

21 Restatement (Third) of Agency § 2.03 (2006).

22 For a recent discussion on return preparer fraud issues, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 34-7 (Area of Focus: *The IRS Agrees It Should Issue Refunds to Victims of Return Preparer Fraud, But It Has Been Slow to Develop Necessary Procedures*). At the end of FY 2015, TAS had 272 return preparer fraud cases in total inventory. Data obtained from TAMIS for FY 2015 (Nov. 1, 2015) (Data represents open cases with Special Case Code PF). The current inventory of return preparer fraud cases includes unresolved cases received in prior FYs.

23 Restatement (Second) of Torts § 918 (1979) ("One is not prevented from recovering damages for a particular harm resulting from a tort if the tortfeasor intended the harm or was aware of it and was recklessly disregardful of it, unless the injured person with knowledge of the danger of the harm intentionally or heedlessly failed to protect his own interests.").

24 Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

account system.[25] In addition, the IRS should revise Circular 230 sanctions to include sanctions for those preparers who conduct, or attempt to conduct, unauthorized transactions on the online account system.

The IRS should develop procedures to enable the taxpayer to undo any unauthorized transactions conducted by the preparer. For example, if the preparer accepts a math error adjustment without the authorization of the taxpayer, the taxpayer could lose the opportunity to seek independent review by the U.S. Tax Court. The IRS should develop procedures to reverse the unauthorized acceptance of the math error adjustment and institute deficiency procedures.[26]

CONCLUSION

As the IRS develops a new online account system for taxpayers, the National Taxpayer Advocate has concerns about preparer access to such system. First, due to the potential for incompetent or unscrupulous preparers to use the system to impose significant harm on taxpayers, it is prudent to restrict access to only those preparers who are already subject to IRS oversight. If the IRS does not restrict access to preparers subject to Circular 230 oversight, it should evaluate the actions preparers can take on the system to protect taxpayers from harm imposed by preparer misconduct. Furthermore, taxpayers are the best equipped to determine the boundaries of the preparer's online access and should have the ability to maintain strict control over preparer authorizations. Finally, such safeguards are meaningless unless the IRS can ensure that preparers do not go beyond those specific authorized activities.

25 IRC §§ 7216, 6713.

26 Treasury should revise Circular 230 to include a sanction for unauthorized access to the online account system. We recommend Treasury revise § 10.51, *Incompetence and Disreputable Conduct*, 31 C.F.R. Part 10, to include specific reference to unauthorized access to the online account system. However, such sanctions may not be applicable to preparers who are not subject to IRS oversight under Circular 230.

RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Limit preparer access to the taxpayer online account system to only those preparers subject to IRS oversight under Circular 230.
2. Develop the online account system so it validates the preparer's PTIN information. If the preparer is not subject to Circular 230 oversight, the system should block certain authorization checkboxes automatically.
3. Develop the online account system so that the taxpayer can adjust preparer authorizations by checking a separate box for each type of action the designated preparer can take on the taxpayer's behalf. The checkboxes should use plain language explanations that Taxpayer Advocacy Panel members and Low Income Taxpayer Clinics have reviewed.
4. Develop procedures to track preparer access to the taxpayer's online account and verify the taxpayer authorized the actions taken.
5. Develop procedures to automatically alert the taxpayer of any preparer activities on the online account system and provide information to the taxpayer on how to report unauthorized access.
6. Work with the Department of Treasury to issue guidance specifically applying the provisions of IRC §§ 6713 and 7216 to unauthorized access to the online account system.[27] In addition, the IRS should work with Treasury to revise Circular 230 sanctions to include sanctions for preparers who conduct, or attempt to conduct, unauthorized transactions on the online account system.

27 IRC §§ 7216, 6713.

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

RESPONSIBLE OFFICIALS

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Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Despite an increase in the number of international taxpayers, the IRS has significantly decreased its overseas taxpayer service presence in recent years.[2] While it has plans to expand international criminal investigation locations,[3] during late 2014 and 2015, the IRS eliminated the last four tax attaché posts abroad, citing a multi-year decrease in its appropriations.[4] Taxpayers who benefitted from these offices now must either call an overwhelmed, tolled IRS telephone number in the United States or obtain information from the irs.gov website.

Apart from the attachés, the only free option[5] 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. ETLA allowed the IRS to learn directly from taxpayers what problems and questions they had, and how it needed to update its webpages and publications to provide the necessary information. In conjunction with terminating ETLA, the IRS also discontinued R-mail, a system that allowed customer service representatives to refer taxpayer questions to employees with specific expertise. By eliminating ETLA and R-mail, the IRS has shut itself off from taxpayers with no way of knowing (unless the taxpayer makes a mistake or the IRS selects his or her return for audit) whether it is providing the

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 National Taxpayer Advocate 2011 Annual Report to Congress 156, fn. 39. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 134-54.

3 See Internal Revenue Service FY 2016 President's Budget 81 (Feb. 2, 2015), *available at* http://www.treasury.gov/about/budget-performance/CJ16/02-06.%20IRS%20FY%202016%20CJ.pdf.

4 There were originally fifteen foreign tax attaché posts. *See id*. On November 30, 2014, the IRS closed its Beijing office. Memorandum from Acting Deputy Commissioner, International (LB&I) to LB&I, Commissioner; SB/SE, Commissioner; W&I, Commissioner; Director, IBC; Director, IIC; Director, PGLD; Director Taxpayer Advocate Services; Office of the Chief Technology Officer; Chief Criminal Investigations; Chief Financial Officer (Oct. 16, 2014). The IRS closed tax attaché offices in Frankfurt, Germany, London, UK, and Paris, France, on June 26, 2015, Sept. 19, 2015, and Dec. 26, 2015, respectively. Memorandum from Acting Deputy Commissioner, International (LB&I), *Post Closures of Frankfurt, London and Paris* (Feb. 18, 2015).

5 Because taxpayers calling abroad may have to pay long distance toll charges, the international taxpayer assistance line is not considered a free option.

service taxpayers need. The net effect is a reversion back to a "push" approach to taxpayer information, as opposed to a dialogue.

The National Taxpayer Advocate has repeatedly written about the unique needs of international taxpayers, which the IRS has been slow to address.[6] Given the overwhelming complexity of international tax rules and reporting requirements and the potentially devastating penalties for even inadvertent noncompliance,[7] the IRS's withdrawal of dialogue makes it more likely taxpayers will get it wrong. The IRS creates an endless cycle of more noncompliance breeding more enforcement, without more proactive taxpayer service through education and interaction, which would help avoid these problems. In addition to the closure of the attachés and the termination of ETLA, the National Taxpayer Advocate remains concerned that:

- Telephone and correspondence service for international taxpayers is inadequate;
- The IRS's plans for expanding self-service options, which although having the potential to benefit international taxpayers, cannot fully replace personal service options, either by phone, face-to-face, or an online chat function; and
- The IRS has no permanent servicewide team focused on service for taxpayers abroad.

With its international taxpayer service strategy, 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. This interaction is vital, and any system of taxpayer service worthy of that name must have avenues for learning from its participants, instead of just telling them.

ANALYSIS OF PROBLEM

International Taxpayers Comprise a Significant Group With Unique Needs and Burdens

The number of U.S. citizens abroad continues to grow, while the numbers of other international taxpayers remain steady. In mid-2015, approximately 8.7 million U.S. citizens lived abroad, compared with about 7.6 million in mid-2014.[8] The number of U.S. military service personnel and dependents stationed overseas as of June 2015 was 174,100 compared to 149,600 in 2014, an increase of over 16 percent.[9] There were also many international U.S. taxpayers who were neither residents nor citizens of the United States,

6 *See, e.g.*, National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 77-82 (Area of Focus: *International Local Taxpayer Advocates Would Provide Valuable Assistance to Taxpayers and Protect Their Rights*); National Taxpayer Advocate 2012 Annual Report to Congress 262-80 (Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*); National Taxpayer Advocate 2013 Annual Report to Congress 205-13 (Most Serious Problem: *International Taxpayer Service: The IRS Is Taking Important Steps to Improve International Taxpayer Service Initiatives, But Sustained Effort Will Be Required to Maintain Recent Gains*).

7 *See* National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 48-52 (Area of Focus: *The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*).

8 *See* U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (May 2014), *available at* http://travel.state.gov/content/dam/travel/CA%20Fact%20Sheet%202014.pdf; U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (Apr. 2015), *available at* http://travel.state.gov/content/dam/travel/CA%20by%20the%20Numbers-%20May%202015.pdf.

9 U.S. Department of Defense, *Active Duty Military Personnel, Strength by Regional Area and by Country* (Mar. 31, 2015); U.S. Department of Defense, Active Duty Military Personnel, Strength by Regional Area and by Country (Mar. 31, 2014), *available at* https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp; U.S. Department of Defense, Active Duty Military Personnel, Strength by Regional Area and by Country (Mar. 31, 2013), *available at* https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp.

evidenced by the approximately 231,000 U.S. individual tax returns filed by nonresident aliens in 2014, compared to 214,000 in 2013.[10]

International taxpayers face unique filing burdens. For example, taxpayers who are not U.S. citizens must apply for an Individual Taxpayer Identification Number (ITIN), an arduous process that often requires mailing original identification documents.[11] U.S citizens, resident aliens, and certain non-resident aliens that have an interest in specified foreign financial assets and meet the reporting threshold, must report their foreign financial assets under the Foreign Account Tax Compliance Act (FATCA).[12] Furthermore, all U.S. persons, that have an interest of $10,000 or more in foreign financial accounts, must file Financial Crime Enforcement Network Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR).[13]

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. This interaction is vital, and any system of taxpayer service worthy of that name must have avenues for learning from its participants, instead of just telling them.

The Closure of Tax Attaché Offices Abroad, Concurrent With the Expansion of the IRS's International Enforcement Presence, Harms Taxpayers and Fails to Provide the Assistance They Need

The closure of the last four overseas tax attachés deprives taxpayers abroad of valuable and necessary services.[14] In 2014 and 2015, the attachés collectively held 19 formal outreach events, with approximately 1,500 attendees.[15] These events focused on topics such as filing requirements, the foreign tax credit, FBAR, and tax law changes; and they included a question and answer portion with the opportunity for one-on-one questions after. In fiscal year (FY) 2014, approximately 5,442 taxpayers walked-in to the London attaché office to seek assistance or ask questions, and the Frankfurt office had over three thousand phone contacts.[16] By providing accessible information about what international taxpayers need to do to comply with the tax laws, the attachés supported taxpayers' *rights to be informed* and *to quality service*.

The interaction between the attachés and taxpayers created a perfect feedback loop: taxpayers came to the attachés for help, and in addition to providing assistance, the attachés learned about issues taxpayers found confusing or about systemic problems. The attachés then incorporated this information into their future presentations and shared it with other IRS employees who were

10 TAS Research & Analysis query of Compliance Data Warehouse (Dec. 15, 2015).

11 *See* Most Serious Problem: *Individual Taxpayer Identification Numbers (ITINs): IRS Processes Create Barriers to Filing and Paying for Taxpayers Who Cannot Obtain Social Security Numbers*, *infra*.

12 For more information about the burdens on taxpayers associated with FATCA, see National Taxpayer Advocate FY 2016 Objectives Report to Congress 48-52 (Area of Focus: *The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*).

13 *See* 31 C.F.R. §§ 1010.350(a), 1010.306(c). All U.S. persons includes U.S. citizens, resident aliens, trusts, estates, and domestic entities.

14 In 1993, the IRS had staff members attached to or located at more than a dozen U.S. embassies abroad. *See* David Kocieniewski, IRS Will Shut Last Overseas Taxpayer Assistance Centers (Jan. 14, 2015), *available at* http://www.bloomberg.com/news/articles/2015-01-14/irs-will-shut-last-overseas-taxpayer-assistance-centers. The Commissioner listed growing the attaché presence as one of the many actions the IRS could take if provided with additional funding of $40.7 million in order to address offshore tax evasion. *See* FY 16 *Treasury Department Budget: Hearing Before the Senate Appropriations Committee, Subcommittee on Financial Services and General Government*, 113th Cong. (2015) (statement of John A. Koskinen, Commissioner, IRS).

15 IRS response to TAS information request (July 22, 2015).

16 *Id*.

responsible for content on irs.gov, or who might be in a position to influence policies or procedures. The following examples illustrate this:

- The Paris attaché received numerous questions about renunciation, so it posted information on this issue on the embassy website and in its brochures.
- The Paris attaché wrote letters to IRS service centers to resolve systemic problems.
- The Beijing attaché reached out to the Affordable Care Office to recommend it add a Frequently Asked Question to its website, which it did, based on recurring questions from international taxpayers.
- The Beijing attaché elevated to the IRS the issue of taxpayers with foreign addresses being unable to use the online transcript request.
- Upon noticing a large number of returns filed that appeared to be part of a fraudulent scheme, the London attaché elevated the issue to Deputy Large Business & International (LB&I) Commissioner, International, and it was referred to the appropriate office.[17]

The attachés also sent monthly reports to IRS headquarters, reporting on trends and the prevailing issues.[18] In this way, the attachés were highly efficient and cost effective because they likely benefited many more taxpayers than just the ones who contacted them.

The interaction between the attachés and taxpayers created a perfect feedback loop: taxpayers came to the attachés for help, and in addition to providing assistance, the attachés learned about issues taxpayers found confusing or about systemic problems.

The attachés also acted as a liaison to community organizations, professional associations, financial institutions, and the embassy and consulate offices in the surrounding region.[19] The Paris attaché reported meeting with practitioners annually to hear about their issues and problems, and incorporated this information into its annual taxpayer service plan. The attachés also had relationships with treaty partners and spent ample time on exchange of information issues. The attachés used their expertise to provide information about laws and overseas procedures to other IRS offices.[20]

Unique to the attachés activities was the direct, two-way interaction between them and taxpayers or stakeholders. Although virtual outreach may be beneficial in the future, and the Paris attaché successfully held two virtual outreach events for expatriates in Nairobi and Barcelona during 2015, these did not provide the opportunity for one-on-one interaction. Furthermore, the IRS relied on the partnership of the Department of State in conducting these events, and has recently cited rejections by the Department of State as reasons for stalled progress on plans to conduct similar outreach events during the next filing season.[21] Even if the IRS is able to orchestrate future virtual sessions without the attachés, providing a one-time brief window will not replace the dialogue that taxpayers had with the attachés throughout the year.

17 TAS conference call with IRS tax attachés (Sept. 24, 2015).

18 *Id*.

19 For example, the Paris office had collaborative relationships with the Organization of Economic Cooperation and Development (OECD) and traveled to meet with treaty partners, embassy officials, and consulates to see what their needs were. *See Id*. The London office had active relationships with a number of expatriate community organizations, as well as professional groups such as the Entertainment Industry Workshop Group and the British-American Business Roundtable. *See* IRS response to TAS information request (July 22, 2015).

20 TAS conference call with IRS tax attachés (Sept. 24, 2015).

21 *Id*.

The National Taxpayer Advocate is concerned that the IRS did not analyze the impact of closing the attachés prior to making its decision. The IRS stated "these closures have relatively little impact on taxpayers and treaty partners;" however, the IRS did not conduct any impact studies to determine the potential effects on taxpayers, compliance, or revenue. The IRS estimated the closures would save $4 million per year.[22] However, at the same time, the IRS has asked for $8.4 million to expand offshore criminal investigations, including opening two additional posts.[23] Impact studies may have considered the effects on voluntary compliance, especially encouraging voluntary payments.[24] Instead of closing the existing attachés, the IRS should analyze the impact of reopening additional attaché offices. In addition, each IRS office abroad should include a Local Taxpayer Advocate (LTA) to provide international taxpayers with better access to TAS, foster increased communication and information sharing, and encourage reporting of systemic issues.[25] Increases in voluntary compliance resulting from better service for taxpayers abroad would more than offset the additional costs.[26]

Shutting Down the Electronic Tax Law Assistance Program Removed the Only Free Option for International Taxpayers to Meaningfully Interact With the IRS

On October 1, 2015, the IRS shut down the ETLA program, the only free method for taxpayers abroad to ask and receive answers to their specific tax law questions without paying toll phone or fax charges.[27] An internal email indicates that a drop in usage since its initiation drove the IRS's decision.[28] However, low usage was by design, as the irs.gov website includes little mention of ETLA.[29] Furthermore, ETLA inquiries have actually increased in recent years, 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.[30] Inquiries from aliens and U.S. citizens living abroad have grown substantially, up 39 percent since FY 2013.[31]

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22 *See* David Kocieniewski, IRS Will Shut Last Overseas Taxpayer Assistance Centers (Jan. 14, 2015), *available at* http://www.bloomberg.com/news/articles/2015-01-14/irs-will-shut-last-overseas-taxpayer-assistance-centers. The IRS requested $283 million for international enforcement resources for FY 2014, and only about $8.5 million for all field assistance for the LB&I Operating Division, which includes a Headquarters office and one other domestic office. IRS response to TAS information request (July 10, 2015).

23 IRS FY 2016 President's Budget 81 (Feb. 2, 2015), *available at* http://www.treasury.gov/about/budget-performance/CJ16/02-06.%20IRS%20FY%202016%20CJ.pdf. Currently, the IRS maintains ten criminal investigation offices overseas. IRS, Criminal Investigation, Fiscal Year 2014 National Operations Annual Business Report, 27, *available at* http://www.irs.gov/pub/foia/ig/ci/REPORT-FY2014-IRS-CI-Annual-Report.pdf.

24 As an example, taxpayer remittances received by the London attaché in FY 2014 totaled almost $27 million. IRS response to TAS information request (July 22, 2015).

25 For a detailed discussion of the need for LTAs abroad, see National Taxpayer Advocate FY 16 Objectives Report to Congress 77-82 (Area of Focus: *International Local Taxpayer Advocates Would Provide Valuable Assistance to Taxpayers and Protect Their Rights*). *See also* National Taxpayer Advocate 2013 Annual Report to Congress 213; National Taxpayer Advocate 2011 Annual Report to Congress 190.

26 More than 98 percent of all tax revenue collected by the IRS is paid voluntarily and timely. In FY 2014, the IRS collected total tax revenue of about $3.1 trillion. Of that amount, it collected $57.1 billion through enforcement actions. Government Accountability Office (GAO), GAO-15-173, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements* 29 (Nov. 2014), *available at* http://www.gao.gov/assets/670/666863.pdf.

27 *See* SERP Alert 15A0387 (Aug. 18, 2015).

28 *See* email from Chief, Electronic Services and Programs, SE:W:CAS:AM:ESP (Aug. 13, 2015).

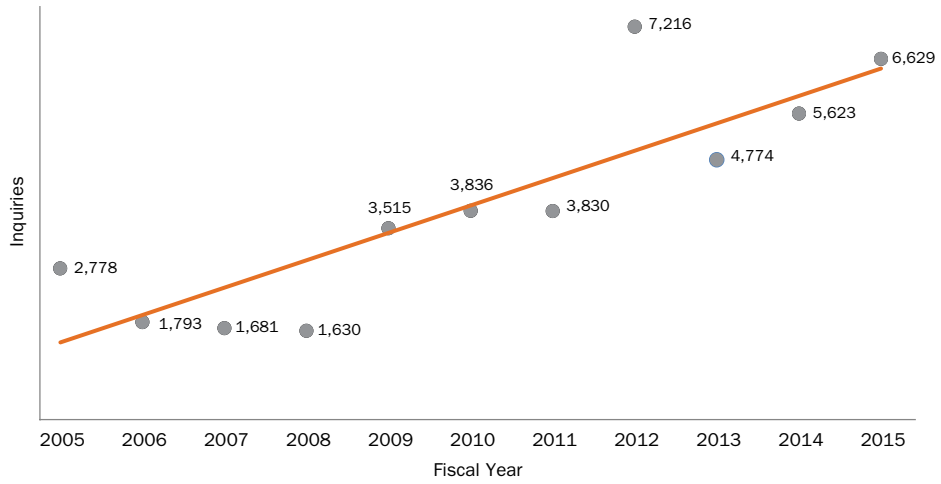
29 A search on irs.gov on August 18, 2015, for "ETLA" or "Electronic Tax Law Assistance" turned up only two web pages on irs.gov, neither of which actually had a link that taxpayers could use to access the ETLA system.

30 ETLA Fiscal Year Reports, FY 2008-2015.

31 *Id*.

FIGURE 1.7.1[32]

Growth in ETLA Inquiries Received From Aliens and U.S. Citizens Living Abroad



Although some ETLA inquires resulted in long wait times for taxpayers,[33] the average response time during FY 2015 for questions related to aliens and U.S. citizens living abroad was only 3.9 days,[34] meaning the IRS was able to manage its resources in a way to efficiently answer these questions. In addition to the superficially low usage rate, the IRS also cites cost as a reason for discontinuing ETLA, comparing the cost per contact of $116 with the cost per contact for toll free assisted calls of $42.[35] However, one ETLA submission is not equal to one telephone call. ETLA questions are usually those that are not covered in online applications or are difficult to understand or interpret in the context of a taxpayer's specific circumstances, meaning they are inherently likely to be more difficult and thus more expensive to answer. Taxpayers could also ask questions 24 hours a day, which is crucial for taxpayers in international time zones.

In conjunction with terminating ETLA, the IRS also discontinued its R-mail program, which was an automated system used to refer specific tax law questions received through ETLA to headquarters employees to clarify confusing issues or instructions. The IRS cited low usage for this program, which is a self-fulfilling proposition, a result of the IRS not answering "out of scope" questions, precisely the type of question that might require a referral.[36] R-mail could have provided a valuable feedback loop between international taxpayers who are experiencing confusion regarding an issue or instruction, and the IRS employee receiving the referral, who can recommend changes to the instructions or procedures based on what the taxpayer identifies as confusing.

32 ETLA Fiscal Year Reports, FY 2005-2015.

33 For example, questions involving the Child Care Credit and Other Credits handled by the Dallas office had an average wait time of nearly 30.1 days for inquiries worked during FY 2015. ETLA Fiscal Year 2015 Report. The IRS has a goal of answering all ETLA inquiries within three business days. Internal Revenue Manual (IRM) 21.3.2.1, *Electronic Tax Law Assistance Overview* (Dec. 10, 2014).

34 ETLA Fiscal Year Reports for inquiries received between October 1, 2014 and September 30, 2015.

35 *See* Briefing Document, *Retiring Electronic Tax Law Assistant (ETLA) and Referral Mail (R-Mail)* (sent by email from Wage and Investment Senior Advisor to TAS, Aug. 31, 2015).

36 IRM 21.2.1.57.2, *Procedures* (Mar. 15, 2012), provides procedures for R-mail telephone referrals and states: "Depending on the complexity of the message, you may determine that a question is outside the scope of the service. IRM 21.2.1.57.2.2.7, "Out of Scope" Procedures."

None of the alternatives to ETLA provide real interaction. The IRS cites various tools on its website,[37] but even the so called "interactive" tools only provide canned responses to questions the IRS has come up with, leaving taxpayers unable to ask their actual questions and the IRS oblivious as to what issues taxpayers have. Contingent on funding, the IRS has proposed two options for virtual webcasts to assist taxpayers abroad who no longer have the benefit of ETLA or virtual outreach conducted by the attachés. The first option includes a live webcast with up to 20,000 attendees where questions can be asked and answered during the webcast. The second option is for a PowerPoint slide webcast with audio that is envisioned to accommodate at least 2,000 attendees and can be recorded for subsequent viewing, but without audience interaction and the capability to respond to audience questions.[38] Even if the IRS is able to achieve the first option, it would provide only a single opportunity for dialogue with a limited number of taxpayers at a time that may not be convenient or when taxpayers even have questions. Given the reliance on ETLA by taxpayers abroad, terminating ETLA as a whole reflects poor decision-making and disregard for international taxpayers' needs.

Telephone and Correspondence Service for International Taxpayers Is Inadequate

Although an increasing number of international taxpayers prefer online services over telephone, non-filers were significantly more likely than filers to want more IRS resources devoted to telephone service as opposed to online service improvements, according to a 2012 IRS survey.[39] This may be because only 58 percent of non-filers surveyed reported having Internet access at home, and 35 percent reported having no Internet access at all.[40] Foreign taxpayers face burdens in calling the IRS, primarily because they must call a domestic IRS office, which may be many time zones away, and pay significant tolls depending on the length of the call. This is especially problematic given the decline in phone service over recent year. In FY 2013, the average wait time on the international phone line was 10.5 minutes, compared to 19.9 minutes in FY 2015, a 90 percent increase.[41] Furthermore, the average level of service on the international phone line in FY 2015 was only 55 percent.[42]

The IRS could accommodate the international taxpayer service need driven by the increase in international enforcement by allocating additional funding for international taxpayer phone lines. Using Voice over Internet Protocol (VOIP) technology could potentially allow the IRS to reduce its phone costs and provide toll-free service to overseas taxpayers. When asked about barriers to using this technology, the IRS response was based solely on its experience as a tenant of the U.S. embassy in London, where the Department of State used such technology, reflecting that the IRS has not researched this possibility.[43]

37 The IRS cites Tax Topics, Tax Trails, and the Interactive Tax Assistant as alternatives, although additions to the Interactive Tax Assistant are contingent on funding. *See* IRS Briefing Document, *Retiring Electronic Tax Law Assistance and Referral Mail* (sent by email from Wage and Investment Senior Advisor to TAS on Aug. 31, 2015).

38 *See* IRS Briefing Document, *Retiring Electronic Tax Law Assistance and Referral Mail* (sent by email from Wage and Investment Senior Advisor to TAS on Aug. 31, 2015).

39 Forty-six percent of nonfilers favored improving telephone service over online service, as opposed to only 30 percent of filers who favored telephone service. IRS, Wage and Investment Research and Analysis, *2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* 10 (Aug. 2012).

40 IRS, Wage and Investment Research and Analysis, *2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* 10 (Aug. 2012).

41 IRS, JOC Snapshot Reports for weeks ending Sept. 30, 2013 and Sept. 30, 2015.

42 IRS, JOC Snapshot Report for week ending Sept. 30, 2015.

43 *See* IRS response to TAS information request (July 22, 2015).

Although many questions can be answered from an online article or the Interactive Tax Assistant (ITA), questions about a taxpayer's account or requests for a manager to explain an employee's handling of their case must be answered over the phone. Furthermore, the term "interactive" in describing the ITA is misleading because the taxpayer only receives one of a number of canned answers to questions the IRS has created on its own.

Although many questions can be answered from an online article or the Interactive Tax Assistant (ITA),[44] questions about a taxpayer's account or requests for a manager to explain an employee's handling of their case must be answered over the phone. Furthermore, the term "interactive" in describing the ITA is misleading because the taxpayer only receives one of a number of canned answers to questions the IRS has created on its own. There is no two-way interaction between the taxpayer and an employee where the taxpayer could receive a specific answer to his or her question and the IRS could learn about how to improve its taxpayer resources based on the taxpayer's question.

The lack of phone service is especially critical given barriers to receiving correspondence abroad. The Treasury Inspector General for Tax Administration (TIGTA) recently found that typographical errors and systemic address limitations lead to undeliverable international mail and registered mail may not be delivered to its intended recipients abroad.[45] TIGTA noted that approximately 855,000 notices and letters were sent to U.S. taxpayers abroad during 2014, but the IRS could not determine how many taxpayers responded.[46] Without effective correspondence or accessible phone service, the IRS infringes a taxpayer's *right to be informed.* Taxpayers abroad may not receive crucial information about their accounts, as well as learn when they need to take actions to exercise their rights. For example, without receiving a Statutory Notice of Deficiency, a taxpayer abroad may not know he or she must petition Tax Court within 150 days to challenge the deficiency in court.[47]

The IRS's Plans for Expanding Self-Service Options, Which Although Having the Potential to Benefit International Taxpayers, Cannot Fully Replace Personal Service Options, Either by Phone, Face-to-Face, or an Online Chat Function

The IRS has improved some self-service resources for international taxpayers; however, most only provide static information, with no way for taxpayers to interact with an IRS employee. In June 2015, the IRS released three YouTube videos for international taxpayers on the topics of filing requirements, the foreign earned income tax exclusion, and ITINs.[48] It also added two new international "Tax Trails," which are a series of "interactive" questions that allow a taxpayer to find canned answers to tax law and tax filing questions chosen by the IRS.[49] The IRS also expanded its coverage of international issues on its "Tax Map," which now includes an index of international issues and provides links to various IRS online articles about specific topics, such as tax treaties or FATCA. In FY 2015, the international pages received 15,484 total

44 The Interactive Tax Assistant is a tax law resource that takes a taxpayer through a series of questions on a limited number of topics and provides responses. *See* http://www.irs.gov/uac/Interactive-Tax-Assistant-(ITA)-1. The term "interactive" is misleading, as the taxpayer only receives one of a number of canned answers to questions the IRS has created on its own, as opposed to interacting with an employee who could answer the taxpayer's specific question.

45 *See* TIGTA, Ref. No. 2015-30-072, *Planned Improvements Have Not Been Made to Manage and Track Correspondence With International Taxpayers* (Sept. 8, 2015).

46 *Id*.

47 IRC § 6213 provides that within 90 days (or 150 days if the notice is addressed to a person outside the United States) after a notice of deficiency is mailed, a taxpayer can petition Tax Court to challenge the deficiency.

48 *See* IRS, IR 2015-85, *New YouTube Videos, Online Resources Help Taxpayers Abroad* (June 4, 2015), *available at* http://www.irs.gov/uac/Newsroom/New-YouTube-Videos,-Online-Resources-Help-Taxpayers-Abroad.

49 *See id*.

hits through June 29, 2015, with the top five non-U.S. visitor countries of origin being: China, UK, Canada, Germany, and Spain.[50]

TAS asked the IRS about its progress during the last two fiscal years on expanding online resources for international taxpayers, including secure messaging portals, Free File fillable forms, e-filing, and improvements to irs.gov. The IRS response reflected the main actions were improvements to irs.gov, which primarily consisted of updating informational webpages. The only significant action was to develop a registration page allowing foreign financial institutions to register with the IRS regarding their participation in FATCA and obtain a Global Intermediary ID Number to use for FATCA reporting.[51]

The IRS should invest in catching up with technology already developed by the private sector to create a secure internet connection for taxpayers abroad so they could communicate with the IRS via an "e-chat" system. The IRS can also pilot the Virtual Service Delivery (VSD) technology it successfully uses for in-person interaction with taxpayers domestically.[52] To avoid security concerns involving foreign Internet Protocol addresses, the IRS could partner with the U.S. Department of State to install VSD terminals at U.S. embassies and consulates. However, before the IRS develops alternatives for taxpayers abroad to interact with IRS employees virtually, it is vital for the IRS to reinstate and maintain the services offered by the tax attachés.[53]

Furthermore, the IRS should not focus its entire international taxpayer service strategy on web-based self-service options. Currently, some taxpayers do not have access to several existing online services. For example, the Get Transcript application cannot be used by taxpayers with ITINs, which are used by individuals not eligible for Social Security numbers. Nonresident alien taxpayers cannot file Form 1040-NR or Form W-7, *Application for IRS Individual Taxpayer Identification Number*, electronically. As explained above, a significant number of taxpayers abroad who did not file returns lack internet access.

The IRS Needs a Permanent Servicewide Team Focused on the Unique Service Needs of International Taxpayers

To specifically address the needs of international taxpayers, in 2012 the IRS created the International Individual Taxpayer Assistance (IITA) team with representatives from the LB&I, the Wage & Investment Division (W&I), the Office of Online Services (OLS) and TAS. Although the team was initially instrumental in updating and streamlining various international IRS webpages, the team's efforts have flagged in recent years. The IRS declined to adopt the National Taxpayer Advocate's 2012 recommendations to make the team permanent with a formal charter and required periodic reporting,[54] and not surprisingly, the team has been largely inactive recently. The team's main actions during the last two fiscal years have been limited to adding content to international taxpayer web pages, with the exceptions of preparing a 2015 filing season information document for U.S. embassies and convening an ad-hoc team in 2015 to

50 *See* IRS response to TAS information request (July 22, 2015).

51 IRS response to TAS information request (July 10, 2015).

52 Virtual service delivery enables taxpayers to interact directly with IRS employees using videoconferencing equipment and allows taxpayers to transmit and discuss documents in real time. Currently, the IRS employs VSD technology at only brick and mortar locations, as opposed to allowing taxpayers to use their own technology equipment at home. The National Taxpayer Advocate has made numerous recommendations over the years to expand the IRS's use of VSD. *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 152-62 (Most Serious Problem: *Virtual Service Delivery: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services*).

53 The National Taxpayer Advocate has also advocated for LTAs to be placed at each international tax attaché office to better serve taxpayers abroad. *See* National Taxpayer Advocate FY 2016 Objectives Report to Congress 77-82 (Area of Focus: *International Local Taxpayer Advocates Would Provide Valuable Assistance to Taxpayers and Protect Their Rights).*

54 *See* National Taxpayer Advocate 2012 Annual Report to Congress 280.

work on virtual outreach sessions.[55] Without formalizing and making permanent the IITA team, taxpayer service for international taxpayers will dissipate further.

CONCLUSION

International taxpayers are a growing population who face declining taxpayer service resources and increased filing and reporting requirements, along with substantial penalties for noncompliance. The closure of the overseas tax attaché offices exacerbates this problem by eliminating a key means of providing outreach and technical assistance, identifying issues with IRS processes and procedures, and learning about current challenges and the needs of international taxpayers. Furthermore, by terminating ETLA and R-mail, the IRS has shut itself off from taxpayers, preventing taxpayers from asking their own questions and preventing the IRS from learning how to better serve taxpayers and prevent problems. The IRS's planned focus on web-based self-service for international taxpayers will not replace the services lost. While in the current budget environment it may be tempting to migrate taxpayer service toward superficially lower-cost self-assistance options, significantly reducing personal service options may ultimately impair voluntary compliance and undermine taxpayers' *rights to be informed* and *to quality service.*[56]

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Reopen the four international tax attaché offices and provide funding for TAS to establish one LTA position at each office.
2. Conduct impact studies to determine the effects on taxpayer service, compliance, and revenue by opening additional tax attaché offices around the world.
3. Reestablish the ETLA (or a similar program) with timeframes for responses and create a process for using the information from ETLA inquiries in updates to IRS internal and external materials, including the irs.gov website.
4. Allocate funding for staffing additional telephone service to accommodate the need created by the expansion of international enforcement activities.
5. Create a task force to analyze and provide a report within one year on the barriers to VOIP usage and partnering with the U.S. Department of State to employ VSD technology for taxpayers at U.S. embassies and consulates.
6. Reinstate the IITA Team, with a formal charter, regular meetings, objectives, and measurable results.

55 See IRS response to TAS information request (July 22, 2015).

56 For a detailed discussion of the Taxpayer Bill of Rights, see http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights.

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

RESPONSIBLE OFFICIALS

Kirsten B. Wielobob, Chief, Appeals
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

An independent and effective Office of Appeals (Appeals) within the IRS is essential for quality tax administration and meaningful protection of taxpayer rights. Appeals' mission is to resolve tax controversies on a basis that is fair and impartial to both the government and the taxpayer and in a manner that will enhance public confidence in the integrity and efficiency of the IRS.[2] Appeals attempts to accomplish these goals and to improve voluntary compliance by providing a prompt, high-quality decision in each case, and by reasonably resolving the maximum number of tax controversies without recourse to litigation.[3]

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."[4] AJAC's stated intent is to reinforce Appeals' mission of administrative dispute resolution by clarifying and separating the negotiation and decision-making role of Appeals from the factual investigations and case development allocated to the Examination and Collection functions.[5] For example, under AJAC, Appeals now will generally treat a Collection information statement (CIS) as verified by Collection, and whenever taxpayers in Examination-based cases raise new issues or present additional

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 IRM 8.1.1.1(1), *Accomplishing the Appeals Mission* (Feb. 10, 2012).

3 *Id.*

4 IRS, Internal Guidance Memorandum (IGM) AP-08-0714-0005, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Collection – Phase 2* (July 10, 2014).

5 IRS, *Reinforcing Appeals' Philosophy: Appeals Judicial Approach and Culture (AJAC) Talking Points* (July 2, 2014), *available at* http://appeals.web.irs.gov/about/ajac.htm. Appeals states that AJAC is intended to emphasize its "quasi-judicial" nature. According to Black's Law Dictionary, "quasi-judicial" is a term not easily definable, but generally connoting "[o]f, relating to, or involving an executive or administrative official's adjudicative acts." Black's Law Dictionary (10th ed. 2014), *available at* http://westlaw.com. Appeals' use of the term "quasi-judicial" is apparently intended to distinguish factual investigations allocated to the Examination or Collection functions from dispute resolution activities on which Appeals would like to focus.

evidence requiring further investigation, Appeals will send the matter back to Compliance for development and evaluation.[6]

Although AJAC's aspirations are commendable, its practical implementation is eroding the very perceptions of fairness and objectivity that it claims to bolster. One commentator stated, "[t]here seems to be something problematic in the procedure for just about everyone involved."[7] Further, non-docketed Examination-based Appeals receipts have steadily fallen and TAS has observed that AJAC cases, at least in some circumstances, may be generating less thorough review than pre-AJAC cases.[8]

The National Taxpayer Advocate has long been a proponent of an independent and effective Appeals process within the IRS.[9] Nevertheless, she is concerned that, in application, AJAC is:

- Being used to intimidate taxpayers and deny their right to an administrative appeal;
- Causing cases to bounce back and forth between Appeals and Compliance; and
- Resulting in curtailed review by Appeals Hearing Officers (Hearing Officers) of IRS Examination and Collection actions.[10]

ANALYSIS OF PROBLEM

AJAC Is Sometimes Being Used to Intimidate Taxpayers and Deny Their Right to an Administrative Appeal

The IRS recently affirmed its commitment to a number of fundamental taxpayer rights, including *the right to appeal an IRS decision in an independent forum.*[11] A meaningful and efficient appeals process is a core element of this taxpayer right, which is also a goal of AJAC. Nevertheless, while striving to operate more efficiently is laudable, the course the IRS is currently pursuing is imperiling taxpayers' access to Appeals.

6 IRM 8.22.7.1.1(2), *Collection Information Statement (CIS)* (Sept. 23, 2013); IRM 8.6.1.6.2, *General Guidelines* (Nov. 14, 2013). "Compliance" will be used hereafter as a collective term to refer to the Examination and Collection functions within the Small Business/Self-Employed Division (SB/SE) and the Wage & Investment Division (W&I). To the extent a portion of the discussion is limited to a particular IRS operating division, that division will be specifically referenced.

7 Diane Freda, *Estate Taxes: Estates Grapple With New Dispute Timelines Under IRS Appeals Procedure*, Daily Tax Rep. (BNA) No. 4, at G-3 (Jan. 7, 2015). *See* her profile at http://www.bna.com/diane-freda-h2147483829/.

8 *See* figure entitled *Comparison of Appeals' Workload by Fiscal Year*, *infra*; Appeals response to TAS information request (May 29, 2015), as supplemented by fiscal year (FY) 2015 data provided by Appeals (Nov. 3, 2015). *See also* anecdotal comments from tax practitioners, *infra*, regarding the diminishing extent and quality of Appeals' review under AJAC.

9 *See* National Taxpayer Advocate 2014 Annual Report to Congress 185; National Taxpayer Advocate 2010 Annual Report to Congress 210; National Taxpayer Advocate 2009 Annual Report to Congress 70.

10 This term refers to any Settlement Officer, Appeals Officer, Appeals Account Resolution Specialist, or other employee holding hearings, conferences, or who otherwise resolves open case issues in Appeals. It further encompasses individuals who conduct or review administrative hearings or who supervise hearing officers. IRS, AJAC FAQs, *available at* http://appeals.web.irs.gov/about/ajac-faq.htm#General (updated July 7, 2014).

11 Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

An effective and available Appeals function is crucial for a variety of reasons, including Appeals' ability to:

- Accept affidavits and weigh oral testimony;
- Consider hazards of litigation; and
- Apply the *Cohan* rule as a means of negotiating a case resolution.[12]

In conjunction with AJAC, Compliance started enforcing a more stringent policy with respect to Information Document Requests (IDRs) and to close cases and bypass Appeals prior to issuing the Statutory Notice of Deficiency (SNOD) unless a taxpayer provides all requested documentation or certifies that no additional information is available.[13] For example, Letter 5262 was originally revised over TAS's objections to read:

> If you don't provide the information requested on the enclosed Form 4564 or contact me to confirm you have no additional information to provide by the response due date listed above, we will close your examination based on the information we have now. If you don't agree, you won't be able to appeal within the IRS before we issue a notice of deficiency.[14]

Nevertheless, a telephone call from a taxpayer confirming that no additional information is available leaves the IRS identically situated to where it would be if the same taxpayer failed to respond to the IDR at all.[15] Yet the outcomes are fundamentally different: in the first scenario, the taxpayer will be able to exercise his or her right to go to Appeals, while in the second scenario, the same taxpayer will be barred from exercising that right.

Although Appeals Judicial Approach and Culture Project's (AJAC) aspirations are commendable, its practical implementation is eroding the very perceptions of fairness and objectivity that it claims to bolster.

When TAS objected to this policy, Compliance initially replied that mistakes would be made and the approach was subject to a learning curve, but the policy was consistent with AJAC.[16] The creation of additional obstacles and absolute prohibitions to an appeal within the IRS under the guise of AJAC has many troubling aspects. Compliance should not stand as the gatekeeper to Appeals. Appeals, not Compliance, should determine its own jurisdiction. Compliance cannot be allowed to sit as both judge and jury in deciding whether IRS information requests are reasonable and whether some lesser degree of information or alternative form of substantiation might be sufficient to allow taxpayers to establish their cases. In fact, that is the "quasi-judicial" role of Appeals — to review Compliance's determinations.

12 The *Cohan* rule was developed under federal case law as a means of allowing the fact finder to estimate deductible expenses where the fact of those expenses, although not their amount, can be substantiated. *See Cohan v. Comm'r*, 39 F.2d 540 (2d Cir. 1930). Note, these various settlement tools can sometimes be used by Compliance (*e.g.*, in the process of resolving coordinated issues, IRM 4.46.5.6.1, *Scope of Settlement Authority* (Mar. 1, 2006)). These resolution mechanisms, however, are not as widely available and commonly applied in Compliance as they are in the Appeals context.

13 TAS is primarily aware of this practice arising within the SB/SE Field Examination function. TAS elevated issue conference with SB/SE (July 30, 2014).

14 Letter 5262, *Examination Report Transmittal-Additional Information Due (Straight Deficiency)* (Aug. 2014); IRM 4.10.8.11, *Eligibility for Appeals Conference and Preliminary Letters (SB/SE Field and Office Examiners only)* (Sept. 12, 2014). The referenced SNOD would allow the taxpayer 90 days to appeal the IRS determination to the U.S. Tax Court.

15 In many situations, this failure to respond could be attributable to circumstances beyond taxpayers' control, such as mail failures, health issues, or extended travel. Further, the required affirmation that the requested information does not exist ignores the possibility that taxpayers may possess the information but may have objections to the scope, relevance, or legality of some of the information sought by the IDR.

16 TAS elevated issue conference with SB/SE (July 30, 2014).

Compliance's approach, wrong in principle, has been made worse in practice by the compressed timelines it has imposed on taxpayers before issuing the SNOD. In the typical Small Business/Self-Employed (SB/SE) field examination, most taxpayers would receive an initial letter that included an information request. In the event that taxpayers did not respond, they soon were sent a second letter in the 5262 series demanding all requested information and threatening the loss of appeal rights if they did not provide that information or inform the IRS it was unavailable. If 15 days elapsed (ten days plus five days for mail handling), or if the IRS was unsatisfied with the taxpayer's response, the SNOD would be issued and Appeals temporarily or permanently bypassed.[17]

TAS received comments from some tax practitioners who believed that they were working with Compliance to provide information and resolve a case, only to be surprised by the unexpected arrival of a SNOD, effectively ending all current administrative dialogue with the IRS.[18] In an op-ed piece from *The New York Times*, a tax practitioner observed that if the compressed timeframes were not adhered to, "the consequences may be dire" and that "I could return home from a vacation or a stay in the hospital to find not only that I am being audited, but that my audit has already been closed and sent to the notice of deficiency unit."[19] Core taxpayer rights — such as *the right to appeal an IRS decision in an independent forum, the right to a fair and just tax system,* and *the right to pay no more than the correct amount of tax* — mean little if the IRS implements policies impairing those rights.[20]

After the National Taxpayer Advocate brought the issue to the attention of senior leadership, the IRS agreed to discontinue the use of the Letter 5262 series on a provisional basis. SB/SE issued a June 9, 2015 memorandum temporarily suspending use of the Letter 5262 series.[21] TAS understands that SB/SE is contemplating reversing itself and reinstituting its previous policy with minor modifications regarding the issuance of SNODs in cases where all requested information is not provided and the taxpayer does not call to confirm the lack of such information.[22] Thus, not only would SB/SE continue to refuse relief to those who already have been denied access to Appeals by the premature issuance of SNODs, but all taxpayers would once again become subject to this risk. The National Taxpayer Advocate urges SB/SE to abandon its attempts to place obstacles between taxpayers and Appeals. SB/SE should permanently discontinue use of the Letter 5262 series and the policies that led to its development.

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17 IRM 4.10.8.11(5), *Eligibility for Appeals Conference and Preliminary Letters (SB/SE Field and Office Examiners only)* (Sept. 12, 2014). As previously noted, taxpayers are provided with 90 days in which to file a petition with the U.S. Tax Court. In many of these cases, the issue will then be sent back to Appeals by the Tax Court if the matter has not been previously considered by Appeals. This additional procedural step, however, subjects taxpayers to unnecessary delays, expenses, complexities, and pitfalls for the unwary.

18 TAS conference call with Low Income Taxpayer Clinic practitioners (Apr. 22, 2015). The information gleaned from this and other similar TAS conference calls is anecdotal and cannot be taken as systemic proof or statistical evidence. Nevertheless, it is consistent with broader impressions formed by TAS from widespread interactions with taxpayers and their representatives.

19 David DuVal, *Beware the I.R.S.'s Speeded-Up Audit*, N.Y. Times (Apr. 29, 2015), *available at* http://www.nytimes.com/2015/04/30/opinion/beware-the-irss-speeded-up-audit.html?emc=eta1&_r=0.

20 Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

21 The impacted letters include Letter 5262, *Examination Report Transmittal - Additional Information Due (Straight Deficiency)*; Letter 5261, *Examination Report Transmittal - Additional Information Due (Claims for Refund)*; Letter 5441, *Response to Letter 5262 - Straight Deficiency, and Office Examination's Use of Letter 950, 30 Day Letter-Straight Deficiency*. *See* SB/SE Memo from Scott Irick, Director, Examination/AUR Policy, *Temporary Suspension of Letters 5262, 5261, 5441, and Office Examination's Use of Letter 950* (June 9, 2015), *available at* http://lmsb.irs.gov/international/dir_compliance/foreign_resident/downloads/Letter%20Suspension%20Memo%202015-0609.pdf.

22 SB/SE response to TAS fact check document (Nov. 16, 2015). While SB/SE does not directly address TAS's understanding, SB/SE's reply states, among other things, "[t]he AJAC 'Reassessment' [which is considering the Letter 5262 series] has developed recommendations that are being elevated for executive review and approval. The team is recommending additional IRM clarifications, letter updates, training, external communications and oversight." *Id*.

In focus groups conducted by TAS, several tax practitioners commented that in their experience, Revenue Agents (RAs) who examine cases in Compliance now often discourage taxpayers from going to Appeals.[23] One practitioner stated, "They (RAs) always try to send me to Tax Court straight from exam; they want me to skip Appeals."[24]

Further, according to some practitioners, Compliance also has been using AJAC as a tool for "bullying" taxpayers in other circumstances.[25] TAS has received some reports that Compliance, under the vague but broad cloak of AJAC, has aggressively demanded that taxpayers sign waivers of the statute of limitations on assessment, extending it for one to two years. These demands have occurred even in cases where taxpayers have only sought a slight extension of time from the IRS to provide requested documents and where sufficient time remained under the existing statutory period of limitations for the case to be transferred to Appeals.[26] The use of procedural leverage by the IRS to intimidate taxpayers, to threaten premature case closures, and to jeopardize taxpayers' access to Appeals is inconsistent with AJAC's avowed purpose.

AJAC has been promoted as having the goal of enhancing "external customer perceptions of a fair, impartial, and independent Office of Appeals."[27] However, in some situations AJAC has been used as an instrument for limiting taxpayers' access to Appeals or coercing them into taking steps not in their best interests.

AJAC Is Causing Cases to Bounce Back and Forth Between Appeals and Compliance

A core policy notion of AJAC is that cases should be fully worked in Compliance and not come to Appeals until the IRS and the taxpayer have reached an impasse.[28] AJAC resulted in the implementation of several directives instructing Hearing Officers to return cases to Compliance for the completion of required factual investigations.[29] If a taxpayer raises a new issue or presents additional evidence at Appeals, then the case is sent back to Compliance if, in the opinion of the Hearing Officer, it requires further investigation.[30] Even in cases where new theories or arguments relying on no additional facts are presented by the taxpayer, AJAC requires Compliance to be consulted for its recommendation.[31]

These strictures effectively narrow Appeals' jurisdiction. Cases where Appeals previously would have been actively involved and sought to negotiate settlements fair to both taxpayers and the government are now returned to Compliance. When implemented on a case-by-case basis, and when informed by the

23 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *Appeals – How Are AJAC and CAP Changes Working?*, 6, 7 (Oct. 2015).

24 *Id*. at 7.

25 TAS conference call with practitioners associated with the American Bar Association Section of Taxation (Mar. 17, 2015).

26 *Id*. Generally, 365 days must be remaining on the statute of limitations for Appeals to accept a proposed deficiency case. IRM 8.21.3.1.1, *New Receipts and Transfers* (Aug. 28, 2014).

27 IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (July 2, 2014).

28 *Reinforcing Appeals' Philosophy: Appeals Judicial Approach and Culture (AJAC) Talking Points* (July 2, 2014), *available at* http://appeals.web.irs.gov/about/ajac.htm.

29 *See, e.g.*, IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (July 2, 2014).

30 IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (Projected as IRM 8.2.1.5(2)(i), (j), *Returning a Case to Examination – Appeals Hearing Officers*) (July 2, 2014).

31 IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (Projected as IRM 8.6.1.6.6, *Taxpayer Raises New Theory or Legal Argument*) (July 2, 2014). This consultation is to be undertaken subject to existing *ex parte* requirements. *Id.*

judgment of the Hearing Officer, such an approach is reasonable and has merit. However, when mandated by means of an inflexible systemic policy, this approach is fraught with inequities and inefficiencies.

According to some tax practitioners, AJAC is being used by Appeals as an inventory control mechanism.[32] The more cases that are bounced back to Compliance, the fewer open cases remain in Appeals' inventory. Some practitioners have observed that Appeals is often quick to embrace this opportunity and return cases to Compliance.[33] Others have related that in the past, Appeals Officers were more open to having conversations and listening to taxpayers' positions, whereas now they are in more of a hurry to move the case along — often back to Compliance.[34] The National Taxpayer Advocate is concerned that Compliance, in turn, will respond to its own expanding inventory pressures by precipitously returning cases to Appeals or bypassing Appeals altogether through the issuance of SNODs.

Appeals' workload has decreased in recent years with overall and non-docketed Examination-based case receipts steadily falling between fiscal years (FY) 2011 and 2015. By contrast, Examination-based docketed cases in Appeals have remained relatively constant, resulting in a proportional increase in such cases. This trend will likely only increase if SB/SE reinstitutes the Letter 5262 series and resumes the practice of bypassing Appeals through the precipitous issuance of SNODs. Docketed cases are expensive and stressful for taxpayers and a resource drain for the IRS. The extent to which AJAC is exacerbating this proportionally increasing trend in docketed Appeals cases will become clearer over time, but, to this point at least, AJAC does not appear to be helping. These trends are shown in the following figure.

FIGURE 1.8.1, Comparison of Appeals' Workload by Fiscal Year[35]

	Nondocketed		Docketed		Overall Case Receipts
	Case Receipts	Percentage	Case Receipts	Percentage	
FY 2011	21,706	50%	22,101	50%	43,807
FY 2012	19,450	46%	23,004	54%	42,454
FY 2013	16,509	43%	21,797	57%	38,306
FY 2014	13,563	37%	23,356	63%	36,919
FY 2015	11,645	33%	23,785	67%	35,430

To further illustrate AJAC's troubling application, a tax practitioner participating in a TAS conference call provided the following example. A part of the factual record in an Appeals case included detailed bank records. The Hearing Officer indicated a willingness to sit down with the taxpayer, review the factual file together, and seek a resolution of the case based on the shared dialogue. However, the case was sent back to Compliance by the Hearing Officer's manager under the auspices of AJAC.[36] Everyone loses in this scenario including the Hearing Officer who was ready, willing, and able to resolve the case; the taxpayer who must incur the additional cost and effort of recommencing the dialogue with Compliance; and the tax system itself, which has placed needless burdens on taxpayers and strained the morale of its employees.

32 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

33 *Id.*

34 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *Appeals – How Are AJAC and CAP Changes Working?*, 6 (Oct. 2015).

35 Data for this figure, which focuses on Examination-based cases, was drawn from the Appeals Response to TAS information request (May 29, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015).

36 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

Along with Hearing Officers whose ability to resolve cases has been limited, similar morale issues are reportedly being experienced by Compliance employees. According to some tax practitioners, certain Compliance personnel expressed the view that Compliance was not adequately consulted in the development and implementation of AJAC.[37] Some Compliance employees have articulated "feelings of anger" at AJAC's provisions and "resentment" when cases are returned from Appeals.[38] Taxpayers and their representatives are placed at an unfair and unnecessary disadvantage when forced to seek justice in such a discordant environment, particularly when the venue for resolution is perpetually in danger of changing.

AJAC Is Resulting in Curtailed Review by Appeals Hearing Officers of IRS Examination and Collection Actions

AJAC also appears to be diminishing the substantive quality of the Appeals' reviews that are taking place. Several participants in TAS focus groups described the Appeals environment under AJAC as having shifted from conversational to adversarial.[39] Another participant in a focus group commented, "My level of confidence in Appeals has declined…"[40]

Taxpayers who grow weary of the administrative hurdles established for case resolution or who lose access to Appeals because of premature case closures may be driven to seek justice beyond the IRS in the judiciary or might drop out of the dialogue and be denied due process altogether.

Where Examination actions are concerned, AJAC precludes taxpayers from raising issues at Appeals that are not first considered by Compliance.[41] According to practitioners, this change in practice by Appeals is significantly unfavorable for taxpayers and detracts from the fair and speedy resolution of cases.[42]

Manifestations of AJAC's attempt to limit Appeals' jurisdiction are also apparent in appeals arising out of Collection cases. For example, in cases involving offers in compromise (OIC) made outside of the collection due process context, Hearing Officers are only allowed to review the OIC in question. They are precluded from offering other collection alternatives as a means of resolving the case.[43] Thus, AJAC removes an important resolution tool from the hands of Hearing Officers, disadvantages taxpayers, and increases the burden on Collection, which, in most situations, will have the case added to its inventory.

Further, in appeals arising pursuant to the Collection Appeals Program (CAP), AJAC clarifies that Hearing Officers are to consider only the "appropriateness" of the decision under review.[44] The sense of tax practitioners interviewed by TAS is that Appeals is interpreting this review as purely procedural in nature.[45] One practitioner who is active in representing taxpayers in CAP reported being

37 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

38 *Id.*

39 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *Appeals – How are AJAC and CAP Changes Working?*, 6 (Oct. 2015).

40 *Id*, at 5.

41 *Aggressive IRS Audit Techniques*, panel discussion, American Bar Association Section of Taxation 2015 Joint Fall CLE Meeting, 65 (Sept. 19, 2015).

42 *Id.*

43 IRM 8.23.3.12, *Alternative Resolutions for Offers* (Oct. 15, 2014).

44 IRM 8.24.1.1.1(9), *Administrative and Legislative History* (Dec. 2, 2014). For a more in-depth discussion of issues surrounding CAP and the ways in which these issues are being exacerbated by AJAC, see National Taxpayer Advocate 2015 Annual Report to Congress, Most Serious Problem: *Collection Appeals Program (CAP): The CAP Provides Inadequate Review and Insufficient Protections for Taxpayers Facing Collection Actions, infra*.

45 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

told by a Hearing Officer that, "If all of the boxes were checked, then Appeals would sustain Collection's decision."[46]

The National Taxpayer Advocate is concerned that these restrictions on Hearing Officers' abilities to resolve controversies will result in the rubber-stamping of actions taken by Compliance, particularly in Collection cases. If Hearing Officers are limited in their ability to evaluate facts and circumstances and apply common sense and good judgment in their discussions with taxpayers, Appeals' core mission will be jeopardized. Hearing Officers should be empowered and encouraged to explore the broadest possible scope of settlement options in furtherance of their role of facilitating administrative dispute resolution. To the extent that this effort would, in the opinion of Hearing Officers, be assisted by the clarification or development of additional facts, they should have the ability to pursue such a course.[47]

To the extent that this ability is curtailed, as is currently occurring under AJAC implementation, both taxpayers and the voluntary tax system will suffer. The IRS Restructuring and Reform Act of 1998 strengthened Appeals in hopes of protecting taxpayers "caught in the IRS hall of mirrors" and providing them with an administrative appeals process that is "truly independent and structured to represent their concerns."[48] If this "hall of mirrors" is reinstituted by AJAC, taxpayers who grow weary of the administrative hurdles established for case resolution or who lose access to Appeals because of premature case closures may be driven to seek justice beyond the IRS in the judiciary or might drop out of the dialogue and be denied due process altogether. In the long run, such outcomes, which are currently being precipitated by AJAC, place extraordinary cost burdens on taxpayers, the government, and the judiciary. Moreover, the preservation of due process rights and the perception of fairness it brings are cornerstones of a successful voluntary tax compliance system, not just of the administrative appeals process.[49]

CONCLUSION

The AJAC project is intended to increase the efficiency and effectiveness of Appeals. While these goals are laudable, current observations indicate that AJAC cases may be taking longer to resolve and, at least in some circumstances, yielding a diminished level of substantive review. AJAC's implementation is eroding the very perceptions of fairness and objectivity that the project was instituted to bolster. In practice, AJAC is being used to limit taxpayer's access to Appeals, causing cases to be bounced back and forth between Appeals and Compliance, and resulting in curtailed review by Hearing Officers. Although AJAC's underlying premise that cases should be thoroughly worked by Compliance is reasonable enough, the manner in which AJAC has been implemented is neither in the best interests of taxpayers nor tax administration.

46 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

47 This authority would be consistent with the independence of Appeals, as it would be exercised in conjunction with Appeals' administrative dispute resolution activities, and would be undertaken separate and apart from the influence of other operating divisions within the IRS.

48 144 Cong. Rec. S7622 (July 8, 1998) (Statement of Sen. Roth).

49 *Reinforcing Appeals' Philosophy: Appeals Judicial Approach and Culture (AJAC) Talking Points*, July 2, 2014, *available at* http://appeals.web.irs.gov/about/ajac.htm; National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 131, 134; National Taxpayer Advocate 2009 Annual Report to Congress 79.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Permanently discontinue the Letter 5262 series and preserve taxpayers' rights to an appeal even in cases where all requested information is not provided to Compliance.
2. Loosen AJAC restrictions to allow Hearing Officers to exercise more discretion regarding whether additional factual development or analysis within Appeals would materially assist case resolution.
3. 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*.
4. 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

RESPONSIBLE OFFICIAL

Kirsten B. Wielobob, Chief, Appeals

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

The IRS developed the Collection Appeals Program (CAP) in stages as a response to congressional concerns regarding the rights of taxpayers subject to collection activity relating to liens, levies, and installment agreements.[2] Congress also established collection due process (CDP) protections under Internal Revenue Code (IRC) § 6320 for liens and IRC § 6330 for levies.[3] Congress believed that the existence of "procedures designed to afford taxpayers due process in collections [would] increase fairness to taxpayers."[4]

Instead, this patchwork of protections has led to some overlapping Collection appeals procedures within the IRS Office of Appeals (Appeals) that are confusing and potentially problematic for taxpayers. CAP hearings do have some attractive aspects in comparison with CDP appeals that make CAP worth preserving, including expanded coverage of collection actions and an expedited timeframe. They remain severely limited, however, in the remedies and scope of review they offer taxpayers, providing no judicial oversight of the outcome and no consideration of collection alternatives.

From fiscal years (FY) 2012 through 2015, approximately 44,500 CDP appeals per year have been received by the IRS, while taxpayers have sought just 4,600 CAP hearings per year over this same period.[5] Approximately 22 percent of taxpayers emerged fully or partially victorious from CAP hearings during these years, while 68 percent of taxpayers were fully or partially victorious in CDP appeals.[6]

CAP would be fairer and more widely embraced if it offered taxpayers and their representatives an expedited resolution vehicle that was combined with a meaningful level of review and a reasonable

1 Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Internal Revenue Manual (IRM) 8.24.1.1.1(1), *Administrative and Legislative History* (Dec. 2, 2014). *See also* Taxpayer Bill of Rights 2 (TBOR 2), Pub. L. No. 104-168, 110 Stat. 1457 (1996).

3 The IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

4 S. Rep. No. 105-174, at 67 (1998).

5 Appeals' response to TAS information request (May 18, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015).

6 *Id*. For a more detailed breakdown of this data and a discussion of the underlying assumptions, see figure entitled "Comparison of Outcome Percentages in CAP Hearings and CDP Appeals," *infra*.

opportunity for a negotiated settlement. CAP hearings that allowed for the consideration of collection alternatives and sought a quality outcome for both taxpayers and the government would provide a real benefit, even if that process required slightly expanded timeframes. The result would likely be more settlements, more balanced outcomes for participants, and a more attractive process for taxpayers.

Absent these improvements, the National Taxpayer Advocate is concerned that:

- Appeals adopts an unnecessarily narrow view of its role within CAP and needlessly restricts the scope of available review;
- CAP's emphasis on speed curtails the effectiveness and meaningfulness of Appeals' review;
- Procedures implemented by the Appeals Judicial Approach and Culture (AJAC) Project exacerbate CAP's shortcomings by adding to the inflexibility of an already limited mechanism;[7]
- Pursuit of a CAP hearing by a taxpayer can inadvertently cause the loss of all substantive administrative and judicial review of a collection action; and
- Taxpayers are underutilizing a potentially valuable Collection Appeals alternative.

ANALYSIS OF PROBLEM

CAP's Narrow Scope of Collection Actions and the Collection Vehicles Covered by It Are the Result of IRS Discretion, Not Congressional Intent

The IRS initially created CAP to provide review of lien, levy, or seizure actions taken or proposed by the Collection function. Only a few months after CAP's initiation, Congress enacted TBOR 2, which, among other things, added IRC § 6159(c) requiring the IRS to "establish procedures for an independent administrative review of terminations of installment agreements (IAs) under this section for taxpayers who request such a review."[8] Later, as part of Internal Revenue Restructuring and Reform Act of 1998 (RRA 98), Congress added appeal rights for rejected installment agreements in the same section relating to offers in compromise (OIC).[9] The treatment subsequently accorded these collection alternatives by the IRS, however, was substantially different.

Although the legislative history of RRA 98 made a passing reference to CAP, Congress defined neither the parameters of CAP nor the manner in which it should operate.[10] The IRS itself determined which Collection actions, now including rejected, modified, or terminated IAs, would be subject to CAP hearings, and then imposed an increasingly narrow scope of review available to taxpayers seeking protection of their rights within CAP.[11] Unlike actions taken or proposed regarding IAs, OICs were not placed

7 For an in-depth discussion of AJAC and its impact on taxpayers, see Most Serious Problem: *APPEALS: The Appeals Judicial Approach and Culture Project Is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*, *supra.*

8 TBOR 2, Pub. L. No. 104-168, 110 Stat. 1457 (1996). The text of IRC § 6159(c) has since been moved to IRC § 6159(e).

9 RRA 98, Pub. L. No. 105-206, Title III, Subtitle E, § 3462(c) (July 22, 1998). *See* IRC §§ 6159(e) and (f); 7122(e).

10 *See* S. Rep. No. 105-174, at 92 (1998); IRM 8.24.1.1.1(4), *Administrative and Legislative History* (Dec. 2, 2014).

11 Independent administrative reviews of terminated IAs are made available under IRC § 6159(e), while independent administrative reviews of rejected IAs are furnished by IRC § 7122(e)(1), and appeal rights with respect to such rejections are provided by IRC § 7122(e)(2). While Congress established these protections, the IRS determined that they would be exercised via CAP. IRM 8.24.1.1.1, *Administrative and Legislative History* (Dec. 2, 2014).

within CAP by the IRS and are subject to broader, more substantive Appeals oversight and resolution procedures.[12]

The legislative history indicates that, over the years, Congress has focused on expanding taxpayer rights through the creation of CDP appeals and the mandated review of adverse determinations regarding IAs and OICs. For the IRS to move IAs under CAP and then conduct CAP hearings in a way that potentially limits the protections afforded by CDP appeals and is less beneficial than OIC reviews is inconsistent with the spirit of TBOR 2, RRA 98, and the Taxpayer Bill of Rights recently adopted by the IRS.[13] More broadly, the restrictions placed on the availability and scope of CAP hearings jeopardize the fundamental rights of taxpayers *to appeal an IRS decision in an independent forum*, *to challenge the IRS's position and be heard*, *to a fair and just tax system*, and *to privacy.*

National Association of Enrolled Agents testimony submitted almost 20 years ago to the National Commission on Restructuring the IRS assessed the limitations of CAP hearings in terms that are as applicable now as they were then.

> The scope of this program is so circumscribed by the procedural limitations imposed that it really does not constitute a true appellate process… We believe the lack of taxpayer and practitioner use of this "appeals" process is ample evidence that this program is not perceived as a fair and independent appellate procedure and believe the Commission ought to examine its intent and practice.[14]

CAP's Emphasis on Speed Comes at the Unnecessary Cost of Meaningful Appeals Review

CAP hearings provide taxpayers with some distinct benefits in comparison to CDP Appeals. CAP hearings, even more so than CDP appeals, can be utilized to challenge a range of Collection actions and can be sought:

- Before or after the IRS files a Notice of Federal Tax Lien (NFTL);
- Before or after the IRS levies or seizes property;
- Before or after the IRS terminates or modifies an IA; or
- After the IRS initially rejects a proposed IA.[15]

On the other hand, CDP appeals can only be pursued after the filing of the *first* NFTL or issuance of the *first* levy with respect to any tax liability.[16] The rejection, modification, or termination of an IA or an OIC do not trigger the right to a CDP appeal, nor are CDP hearings available for *subsequent* liens or levies.[17]

12 IRM 8.23.1.3, *Conference and Settlement Practices* (Oct. 10, 2014). Note that an exception to the more robust protections generally granted to taxpayers under the OIC regime occurs if the IRS determines that the OIC was filed solely to delay collection, in which case the OIC will be rejected and collection activity recommenced. IRM 5.8.4.20, *Offer Submitted Solely to Delay Collection* (May 10, 2013).

13 For a more in-depth discussion regarding the potential ways in which CAP hearings can limit CDP rights, see the below section entitled *The Choice By a Taxpayer to Pursue a CAP Hearing Can Inadvertently Result In the Loss of All Substantive Administrative and Judicial Review of a Collection Action*.

14 Written testimony of Joseph F. Lane, Enrolled Agent on behalf of the National Association of Enrolled Agents, submitted to the National Commission on Restructuring the IRS (Feb. 26, 1997), *available at* http://www.house.gov/natcommirs/naea1.htm.

15 IRM 8.24.1.2(2), *Collection Appeals Program* (CAP) (Dec. 2, 2014).

16 IRC § 6320(a).

17 IRC § 6330(a). *See* IRM 8.22.4, *Collection Due Process Appeals Program* (Sept. 25, 2014). *See also* IRM 8.24.1.1.1, *Administrative and Legislative History* (Dec. 2, 2014).

An additional benefit of CAP hearings is that they are designed to provide taxpayers with an expedited response. Appeals attempts to move CAP proceedings forward quickly, ideally within five business days, with Hearing Officers generally directed to make CAP cases their first priority.[18] The average cycle time for resolution of a CAP proceeding during FYs 2012 through 2015 is 13 days.[19] By contrast, the average cycle time for a CDP appeal during the same period is approximately 196 days.[20]

These benefits under CAP as it is currently conducted come at a cost, however. Taxpayers are not allowed to challenge the underlying liability in a CAP hearing and cannot later seek judicial review of the CAP determination.[21] Further, Hearing Officers conducting a CAP proceeding undertake only a procedural review "of the action proposed or taken based on law, regulations, policy and procedures considering all the facts and circumstances."[22] As part of this inquiry, Appeals will not consider Collection alternatives (*e.g.*, IAs or OICs) to the issue under appeal or otherwise seek the "best" answer. By contrast, CDP appeals will weigh collection alternatives or challenges to the liability, and balance the proposed collection action with the taxpayer's legitimate concern regarding intrusiveness.[23]

Likely as a result of the limited review and remedies provided by the CAP process, taxpayers infrequently prevail in CAP hearings. The converse, however, is true in the case of CDP appeals. A comparison of these outcomes in contested proceedings is illustrated in the following figure.

FIGURE 1.9.1, Comparison of Outcome Percentages in CAP Hearings and CDP Appeals[24]

Outcome	Review Method	FY 2012	FY 2013	FY 2014	FY 2015
Percent of Cases IRS Fully Sustained	CAP	74%	76%	81%	80%
	CDP	34%	31%	32%	33%
Percent of Cases IRS Only Partially Sustained or Fully Overturned	CAP	26%	24%	19%	20%
	CDP	66%	69%	68%	67%

18 IRM 8.24.1.2.7, *Case Procedures Under CAP* (Dec. 2, 2014).

19 Appeals' response to TAS information request (May 18, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015). Cycle time for non-docketed closed cases is measured from the point when a taxpayer's request for a hearing is filed with the IRS until a CAP proceeding is closed.

20 *Id.*

21 IRM 8.24.1.1.1(10), *Administrative and Legislative History* (Dec. 2, 2014); IRM 8.24.1.1.1(5), *Administrative and Legislative History* (Dec. 2, 2014). *See, e.g.*, *Budish v. Comm'r*, T.C. Memo 2014-239.

22 IRM 8.24.1.1.1(9), *Administrative and Legislative History* (Dec. 2, 2014).

23 IRM 8.24.1.1.1, *Administrative and Legislative History* (Dec. 2, 2014); National Taxpayer Advocate 2014 Annual Report to Congress 185.

24 Where outcome percentages are concerned, the extent to which the IRS position is sustained by Appeals generally indicates that the taxpayer's position has been unsuccessful to the same degree. Data for this figure is drawn from the IRS response to TAS information request (May 18, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015). The term "Percent Fully Sustained Cases" reflects closing code 14 data taken from the responses provided by Appeals. The term "Percent Partially Sustained or Fully Overturned Cases" reflects closing codes 15 and 16 data taken from the responses provided by Appeals. The comparisons are expressed as a percentage of the data furnished by Appeals under the category "Other Nondocketed Total" in Tab 1 and Tab 2 respectively, which category best captures the vast majority of contested cases. In order to reflect the different natures of CDP proceedings and CAP hearings, which have a five-day turnaround so few withdrawals take place, Appeals includes withdrawn cases under code 14 for CAPs and under code 16 for CDPs. CAP withdrawals have the same effect as CAP sustentions—that being no change to Collection's position. As a result, CAP withdrawals are included under closing code 14. *See* Appeals Clarification Response (June 19, 2015). For CAP closing codes, see IRM 8.24.1.3, *APS CAP Case Closing Procedures* (Dec. 2, 2014); for CDP and Equivalent Hearing closing codes, see IRM 8.22.9.8, *Closing Codes for CDP, EH, and RJ Hearings* (Nov. 13, 2013).

CAP hearings and CDP appeals have distinct reasons for existing and play different roles. Each review mechanism is valuable and should be preserved. Nevertheless, CAP hearings should more effectively protect taxpayer rights and serve the needs of taxpayers subject to a Collection action, which in turn will minimize IRS rework.

CAP's primary weakness is its inflexibility, expressed in terms of a lack of substantive review and a prohibition against the consideration of alternative Collection options. CAP's rigidity and limited parameters are partially explained by Appeals' laudable desire to hasten review and provide an expedited decision. Nevertheless, an incomplete or ill-considered decision is not made better for having been reached more quickly. While speed is an important priority, Appeals should also focus on allowing a robust review and dialogue with taxpayers so that CAP proceedings can reach the best decision for all concerned at the earliest possible stage.

CAP hearings and CDP appeals may, of necessity, involve different degrees of substantive review. Nevertheless, CAP hearings should still include a meaningful level of inquiry sufficient to allow for the consideration of Collection alternatives and a quality answer based on the existing facts after remand to Collection when the circumstances dictate.

For example, assume that Collection proposed filing an NFTL against a financial advisor who is concerned that the impact on his credit report would jeopardize his employment status.[25] As a result, the taxpayer filed for a CAP hearing. Currently, the Hearing Officer would undertake a review to determine only whether Collection followed the applicable procedures. The Hearing Officer would not consider Collection alternatives, which would involve an examination of whether Collection had reasonably balanced the government's need for efficient collection of taxes with the legitimate concerns of the taxpayer. Thus, the Hearing Officer would not necessarily examine the effect of the NFTL on the taxpayer's ability to maintain or find employment in the financial industry, thereby potentially imperiling the taxpayer's job and the government's ability to collect the taxes — a lose-lose situation for both parties.[26]

The taxpayer and the government would benefit considerably if the Hearing Officer reviewed the proposed NFTL to see if the taxpayer had offered reasonable collection alternatives and Collection had properly considered these alternatives and the intrusiveness of the proposed NFTL. If not, a remand for such consideration or for pursuit of an OIC would be highly desirable for all concerned, regardless of whether Collection had the legal authority to file the NFTL in the first instance. If this additional review requires a 14-day or 21-day, rather than a five-day, target for resolution, then the time would be well spent.

Procedures Implemented by the Appeals Judicial Approach and Culture (AJAC) Project Only Exacerbate CAP's Shortcomings

Unfortunately, under AJAC, the IRS appears to be moving precisely in the wrong direction. IRM changes implemented with respect to CAP hearings as part of AJAC clarify that "Appeals does NOT consider alternatives to the issue under appeal, but solely determines the appropriateness of the issue under

25 IRM 5.12.2.6(1), *NFTL Filing Criteria* (Oct. 14, 2013). In general, an NFTL will be filed if the aggregate unpaid balance of assessments is $10,000 or more.

26 IRM 5.12.2.4(6), *Determination Criteria for Do-Not-File or Deferring the NFTL Filing* (Jan. 1, 2015). The filing of an NFTL may be deferred where the Revenue Officer can substantiate with reasonable certainty, supported by documentation from the taxpayer, that filing the NFTL will hamper collection.

To be effective, the Collection Appeals Program (CAP) hearings should examine Collection alternatives, at least to the extent they shed light on the appropriateness and intrusiveness of the collection action, and the case should be remanded to Collection for consideration of those alternatives when necessary.

appeal."[27] Thus, Hearing Officers are directed only to sustain or not sustain Collection's position and are expressly admonished not to negotiate any Collection alternatives.[28]

This approach is bad for taxpayers and counterproductive for the IRS. For example, under the current guidance, if Compliance follows the applicable procedural rules in proposing an NFTL filing, even if the lien is inadvisable and there are other viable collection alternatives, the Hearing Officer will be required to approve the NFTL filing. This regime jeopardizes the taxpayer's *rights to privacy* and *to a fair and just tax system*, and will inevitably cause the IRS to do substantial downstream work to address harmful and unnecessary Collection actions. To be effective, CAP hearings should examine Collection alternatives, at least to the extent they shed light on the appropriateness and intrusiveness of the collection action, and the case should be remanded to Collection for consideration of those alternatives when necessary.

According to responses obtained from focus groups and TAS interviews with tax practitioners, these procedural clarifications made under AJAC have added to the inflexibility of an already limited review mechanism.[29] Some taxpayer representatives have reported that, prior to AJAC, they typically were able to obtain face-to-face conferences with Hearing Officers.[30] Nevertheless, the renewed emphasis on narrow scope and quick disposition of cases under AJAC has led to a general inability to engage in such conferences, even though practitioners view face-to-face conferences as an essential element of the accurate and equitable disposition of taxpayers' cases.

The rush to disposition is particularly problematic in CAP cases involving IAs which, according to tax practitioners interviewed by TAS, often require approximately 30 days for proper consideration and reasonable disposition.[31] This extra time occasionally is necessary for taxpayers to answer questions raised by Hearing Officers and to obtain and present requested documentation. Nevertheless, such cases, along with other CAP cases, now are rigorously subjected to the five-day rule, often to the detriment of taxpayers whose arguments may require considerably longer than five days for proper presentation or thorough consideration.[32]

Further, some taxpayer representatives have reported instances in which CAP Hearing Officers are simply "rubber stamping" Collection decisions after only a nominal review.[33] One practitioner who is active in representing taxpayers in CAP related a comment by a Hearing Officer that "[i]f all of the boxes were checked, then Appeals would sustain Collection's decision."[34] The lack of oversight by Appeals and its unwillingness to consider legitimate arguments are more troubling to these representatives than even an unfavorable outcome reached after an unbiased and comprehensively conducted proceeding.[35]

27 IRM 8.24.1.1.1(9), *Administrative and Legislative History* (Dec. 2, 2014).
28 *Id.*
29 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).
30 *Id.*
31 *Id.*
32 *Id.*
33 *Id.*
34 *Id.*
35 *Id.*

Pursuit of a CAP Hearing by a Taxpayer Can Inadvertently Cause the Loss of All Substantive Administrative and Judicial Review of a Collection Action

One of the dangers confronting taxpayers as they try to choose between their CAP and CDP options is the chance that an inopportune decision could cost them the possibility of a substantive review. If a taxpayer proceeds with a CAP hearing and if that proceeding concludes before a CDP appeal is lodged, then the issue raised and considered at the CAP hearing may be precluded from consideration in a subsequent CDP appeal.[36] This risk exists because the completed CAP hearing can be viewed as a "previous administrative proceeding" under IRC § 6330(c)(4).[37]

For example, assume that a taxpayer pursues a CAP hearing with respect to a proposed levy that is sustained by Appeals because Collection followed the requisite procedural steps. Thereafter, the taxpayer may be denied access to a CDP with respect to this initial levy based on the argument that the matter is now barred from review because the taxpayer is raising no new issues. In this event, the taxpayer would lose the additional benefits conferred in a CDP appeal such as substantive review, consideration of Collection alternatives, application of the balancing test, and judicial oversight of the outcome.

Even if the issue is not precluded from a subsequent decision in a CDP appeal because the CDP request was filed prior to, or concurrently with, the CAP hearing, the Hearing Officer conducting the CDP appeal still has the option of adopting the decision made in the CAP proceeding as part of the CDP determination.[38] Hearing Officers are allowed to take this approach as long as the taxpayer does not present any new information or arguments in the CDP appeal regarding the issue raised in CAP.[39] A CDP review would be appropriate if a taxpayer raised collection alternatives, but the risk remains in this uncertain environment that a Hearing Officer might mistakenly invoke issue preclusion or adopt the prior CAP decision in any event. Thus, under a variety of circumstances, taxpayers availing themselves of the attractive aspects of CAP could unwittingly forfeit their ability to seek a CDP appeal.[40]

These potentially binding effects of a CAP hearing on a CDP appeal would be less problematic if the scope of review conducted in these proceedings and the rights they confer were synonymous, but they are not.[41] The more searching inquiry required by a CDP appeal arguably should be construed as a "new issue" and thus should be separately pursued as part of the ensuing CDP appeal. Nevertheless, many taxpayers, particularly low income taxpayers, may lack the legal sophistication or legal representation to frame such nuanced arguments. As a result, such taxpayers may believe an adverse CAP decision automatically precludes any further consideration of the issue and may therefore not even raise the matter in a later occurring CDP appeal.

36 IRC § 6330(c)(4). IRS Office of Chief Counsel Memorandum, *Collection Appeal Program and I.R.C. § 6330(c)(4) Issue Preclusion*, PMTA 2012-14, 4 (May 3, 2012). For this issue preclusion to occur, the taxpayer must meaningfully have participated in the CAP appeal and the issue under consideration in the two proceedings must be identical. *Id*. Doubts are to be resolved in favor of the taxpayer. IRM 8.22.5.5.1(2), *Issues Excluded under IRC 6330(c)(2)(B) and I.R.C. 6330(c)(4)(A)* (Mar. 29, 2012). Nevertheless, this determination has few meaningful parameters, and taxpayers finding themselves in such a situation are left in a highly uncertain and vulnerable position.

37 *Id.*

38 *Id.*

39 *Id.*

40 Note that if a taxpayer requests both a CDP and a CAP regarding a proposed levy or NFTL filing, the taxpayer is required to choose one or the other. IRM 8.24.1.1.1(8), *Collection Appeals Program Overview* (Dec. 2, 2014). Some taxpayers, however, particularly low income taxpayers, may lack the sophistication or legal representation, to adequately understand the ramifications of their choices in the absence of a thorough explanation from the Hearing Officer, which may not be forthcoming.

41 IRM 8.24.1.1.1(5), *Collection Appeals Program Overview* (Dec. 2, 2014).

Moreover, Hearing Officers themselves may not be immune from confusion regarding the impact of a CAP decision. A request for CDP consideration of an issue previously included in a CAP hearing may erroneously be denied by Hearing Officers unaware that their exercise of the additional substantive review inherent in a CDP appeal generally would require a thorough reconsideration of the issue previously presented in a CAP proceeding. Alternatively, Hearing Officers, while not specifically invoking issue preclusion, may still adopt a prior CAP determination rather than providing taxpayers with the more in-depth substantive CDP analysis to which they are entitled.

In an effort to quantify the magnitude of this problem and analyze the extent to which taxpayers availing themselves of CAP hearings are being denied CDP appeals, TAS requested specific data from Appeals regarding issue preclusion and the adoption of CAP determinations in CDP cases. Appeals responded that it did not track such data.[42]

Taxpayers Are Underutilizing a Potentially Valuable Collection Appeals Alternative

The available data illustrates that CAP is used relatively infrequently by taxpayers and their representatives. From FY 2012 through 2015, approximately 44,500 CDP appeals per year have been received by the IRS.[43] On the other hand, taxpayers have sought only 4,600 CAP hearings per year over this same period.[44] Thus, CAP usage has represented barely ten percent of CDP utilization.

This relatively low use of CAP may, at least in part, be attributable to the circumstance that outcomes are comparatively unfavorable for taxpayers. Between FY 2012 and 2015, only 22 percent of taxpayers emerged fully or partially victorious from CAP hearings, while 68 percent of taxpayers were fully or partially victorious in CDP appeals during this same period.[45]

The relatively few negotiated settlements in the Collection Appeals Program (CAP) hearings and the poor outcomes that CAP hearings generate for taxpayers when Appeals does reach a decision may well help explain why most taxpayers and their representatives decline to pursue this course.

Further, between FY 2012 and 2015, virtually no CAP proceedings were closed as "agreed" by Appeals.[46] By contrast, well over half of the CDP appeals filed during these years yielded a compromise between the IRS and taxpayers.[47] The relatively few negotiated settlements in CAP hearings and the poor outcomes that CAP hearings generate for taxpayers when Appeals does reach a decision may well help explain why most taxpayers and their representatives decline to pursue this course.

CAP would be more widely embraced if it offered taxpayers and their representatives an expedited resolution vehicle that was combined with a meaningful level of review and the reasonable opportunity for a negotiated settlement. CAP hearings that allowed for the consideration of collection alternatives and sought a quality outcome for both taxpayers and the government would provide a real benefit, even if that process required slightly expanded timeframes. The result likely would be more settlements, more balanced outcomes for participants, and a more attractive process for taxpayers. Failure to implement such improvements creates unnecessary downstream rework for the government and

42 Appeals' response to TAS information request (May 18, 2015).

43 *Id.*

44 *Id.*

45 *Id.* For a more detailed breakdown of this data and a discussion of the underlying assumptions, see figure entitled *Comparison of Outcome Percentages in CAP Hearings and CDP Appeals*, *supra*.

46 *Id.*

47 *Id.*

perpetuates an antagonistic environment because taxpayers have difficulty exercising their *right to challenge the IRS's position and be heard.*

Another cause for the underutilization of CAP appears to be the lack of awareness regarding its availability. Although CAP is mentioned on irs.gov, it is not readily apparent and could be easily overlooked. Moreover, some taxpayer representatives interviewed by TAS stated that no one in the IRS had ever mentioned CAP to them or the taxpayers they represented.[48] After implementing the improvements in CAP discussed above, the IRS should increase its efforts to publicize the benefits of CAP, both to taxpayers and their representatives. This enhanced publicity could begin by increasing the profile of CAP on irs.gov as a potential mechanism for contesting Collection actions. Further, the IRS should remind Hearing Officers and all IRS employees with taxpayer contact of the importance of verbally communicating this alternative Collection Appeals process to taxpayers.

CONCLUSION

The IRS created the restrictive regime currently applicable to CAP hearings and has the power to improve it. While preserving the concept of expedited review, the IRS should deemphasize speed as the defining principle of CAP hearings in favor of more meaningful review overall and issue resolution. As the quality and independence of CAP hearings improve, usage will expand, and both taxpayers and the IRS will benefit from increased resolution of Collection issues at an earlier stage in the administrative process.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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.
2. 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.
3. After implementing the improvements in CAP discussed above, 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.

48 TAS conference call with Low Income Tax Clinics practitioners (Apr. 22, 2015).

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

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF THE PROBLEM

Taxpayers rely on Individual Retirement Accounts (IRAs) or defined contribution plans, such as 401(k) plans, or Thrift Savings Plans (TSPs) for federal employees, to fund living and other expenses after retirement. With rising medical and hospice care costs, many retirees are struggling to cover their basic living expenses. The Employee Benefits Retirement Institute (EBRI) estimates only 56.7 percent to 58.5 percent of Baby Boomers and Gen Xers are sufficiently funded for life after retirement.[2] Social Security benefits account for only about 40 percent of retirees' total income, meaning Americans should be funding retirement plans to make up the shortfall.[3] 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.[4]

Congress has given the IRS broad powers to collect taxes, including the authority to levy on a taxpayer's property and rights to property.[5] This power to levy extends to funds held in retirement accounts. Given the long-term importance of retirement assets to individuals' future welfare, the IRS regards retirement levies as "special cases" that require additional scrutiny and managerial approval.[6] However, the IRS

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Jack VanDerhei, *"Short" Falls: Who's Most Likely to Come Up Short in Retirement, and When?*, Employee Benefits Retirement Institute Notes, Vol. 35, No. 6, June 2014, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_06_June-14_ShrtFlls-HSAs.pdf. For purposes of this study, Baby Boomers are defined as the generation born between 1948 to 1964 and Gen Xers are the generation born between 1965 and 1974.

3 *See* Social Security Administration (SSA), *available at* http://www.ssa.gov/policy/docs/ssb/v65n3/v65n3p1.html (last visited Dec. 4, 2015); SSA, *Retirement Planner: Learn About Social Security Programs*, *available at* http://www.socialsecurity.gov/planners/retire/r&m6.html (last visited Dec. 4, 2015); Association for the Advancement of Retired Persons, Affording Retirement: Social Security Alone Isn't Enough, *available at* http://www.aarp.org/work/social-security/info_06_2010/ss_isnt_enough.html (last visited Dec. 4, 2015).

4 For example, the Employee Retirement Income Security Act of 1974 (ERISA) was enacted to provide protection for participants in pension and health plans in private industry. *See* Pub. L. No. 93–406, 88 Stat. 829 (1974).

5 *See* IRC § 6331.

6 Internal Revenue Manual (IRM) 5.11.6.2(3) (Sept. 26, 2014).

guidance that explains the steps required before a retirement account can be levied contains inadequate detail and is insufficient to protect taxpayer rights.[7]

The National Taxpayer Advocate has highlighted several concerns to show current guidance is not sufficient to protect taxpayer rights including the following:

- The guidance regarding flagrant conduct (a prerequisite for the levy) lacks definition and clarity;
- There is inadequate instruction for analyzing future retirement calculations and no requirement to provide those calculations to the taxpayer;
- The IRS does not educate the taxpayer about what to do to avoid a levy, or discuss alternative collection options with the taxpayer prior to a levy on a retirement account;
- The IRS does not conduct a risk analysis similar to the pre-seizure and pre-levy considerations;
- The IRS does not track levies that are issued against particular retirement accounts and therefore is unable to conduct quality reviews to ensure taxpayers are being treated uniformly and employees are following existing guidance; and
- The IRS proposed a TSP levy pilot program 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 collection treatment of TSP accounts compared to other retirement accounts.

The current Internal Revenue Manual (IRM) procedures and the proposed ACS pilot undermine both taxpayer rights and retirement security policy.

ANALYSIS OF PROBLEM

Background

Internal Revenue Code (IRC) § 6331 gives the IRS the right to levy on a taxpayer's property and rights to property. This power allows the IRS to levy on funds held in retirement accounts.[8] Generally, the levy on a retirement account will only reach the funds over which the taxpayer has a present withdrawal right (*i.e.*, a levy will not attach until the taxpayer has a present right to withdraw funds from the plan).[9]

The IRS has established three steps that must be taken before it can issue a notice of levy on a taxpayer's retirement account:

1. Determine what property (retirement assets and non-retirement assets) is available to collect the liability;
2. Determine whether the taxpayer's conduct has been flagrant; and
3. Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[10]

7 *See* IRM 5.11.6.2(4)-(7) (Sept. 26, 2014).

8 For information on what constitutes a retirement plan, see IRC § 4974(c). The IRS may also levy on retirement income or distributions once the taxpayer retires. IRM 5.11.6.1, *Retirement Income* (Jan. 22, 2010).

9 IRM 5.11.6.2(8) (Sept. 26, 2014).

10 IRM 5.11.6.2(4)-(7) (Sept. 26, 2014).

The Small Business/Self-Employed (SB/SE) Area Director, Field Collection, must approve the notice of levy by signing the form as the Service Representative or by following IRM 5.11.1.3.5.[11] However, any notice of levy that requires the approval of the SB/SE Collection Area Director must include a memorandum explaining the IRS employee's justification for the levy.[12] The written information provided to the manager must include:

1. A summary of any information the taxpayer has provided that may affect the decision to levy, *e.g.*, claims that the assessment is wrong;
2. If the taxpayer has submitted such information, an analysis of that information and why the notice of levy should still be served;
3. Verification that the amount is still owed, *e.g.*, IDRS confirms the amount is still unpaid;
4. An explanation that the notice of levy is appropriate in consideration of the amount owed and any circumstances that are known about the taxpayer and the liability; and
5. Other collection alternatives considered and rejected.[13]

When a distribution occurs as the result of a levy, the taxpayer will experience tax consequences. First, pursuant to IRC § 408(d), generally, the entire amount paid from a retirement account or any distribution, is considered gross income and is subject to taxation. In the instance of a levy on a retirement account, the payor would be required to withhold ten percent.[14] However, this amount of withholding is not guaranteed to be sufficient to cover the federal tax liability created by the distribution, and the taxpayer may be liable for a state income tax as well.[15]

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.

The IRM Guidance Regarding Flagrant Conduct Lacks Definition and Clarity

According to IRM guidance, if the IRS determines that a taxpayer has engaged in flagrant conduct, it may levy on a retirement account.[16] However, the guidance also provides that if a taxpayer has *not* engaged in flagrant conduct, then the levy should not occur.[17] Thus, the determination of flagrant behavior is a prerequisite for determining to levy on a retirement account. IRS employees are instructed to make a determination of flagrancy on a case-by-case basis and may consider extenuating circumstances that mitigate otherwise flagrant behavior.[18]

However, there is no on-point definition of what constitutes "flagrant" behavior in the IRC, accompanying regulations, or the IRM. The IRS has addressed "flagrant" in regulations related to excise taxes on exempt organizations (EOs). That guidance provides that "a willful and flagrant act (or failure to act) is one which is voluntarily, consciously, and knowingly committed in violation of any

11 IRM 5.11.6.2(10) (Sept. 26, 2014).
12 IRM 5.11.1.3.5(6) (Aug. 1, 2014).
13 IRM 5.11.1.3.5(2) (Aug. 1, 2014).
14 IRC § 3405(b)(1). The payor generally is responsible for making this withholding, but the plan administrator may be liable in the case of certain plans. IRC § 3405(d)(1).
15 Generally, there is a ten percent additional tax on early distributions from a qualified retirement plan but this additional tax does not apply to distributions made from an account because of an IRS levy. IRC § 72(t)(2)(A)(vii).
16 IRM 5.11.6.2(5) (Sept. 26, 2014).
17 *Id*.
18 *Id*.

provision of chapter 42 (other than IRC §§ 4940 or 4948(a)) and which appears to a reasonable man to be a gross violation of any such provision."[19] The United States Tax Court applied this definition in determining that a trustee's actions were flagrant and therefore subject to a penalty assessment under IRC § 6684.[20] This language could provide an analytical framework for defining "flagrancy" in the IRM as it relates to retirement accounts. Without a clear definition of flagrant conduct, this vital element of the analysis cannot occur on a consistent and meaningful basis. The key elements for a flagrant act should be that it is committed in a willful and voluntary manner and that a reasonable person would view it as a gross violation.[21]

Without a definition of flagrant conduct, the IRS employee must make this determination based on examples in the IRM guidance. Several examples of flagrant conduct listed in the IRM include the following:

- Taxpayers who continue to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed; or
- Taxpayers who voluntarily contributed to retirement accounts during the time period the taxpayer knew unpaid taxes were accruing.[22]

By statute, federal employees, without their consent, are automatically enrolled to have a certain percentage (typically three percent) of their salary contributed to the TSP.[23] This is done to encourage saving for retirement and to take advantage of employer matching; federal employees must take an affirmative step to stop these automatic contributions.[24] Other employer plans adopt a similar "opt-out" approach to automatically enroll employees.[25] Thus, an employee may have been contributing to a retirement plan via automated payroll deductions for years before incurring an IRS debt and may not be aware the IRS views such contributions to be flagrant conduct. Indeed, if the IRS adopted an EO definition of flagrant conduct discussed above (*i.e.*, voluntary, conscious, and knowing), it is questionable whether their contributions would constitute flagrant conduct.

The examples described above are overly broad in terms of discouraging retirement savings for *any* taxpayer with an outstanding liability. The guidance goes against strong public policy that encourages saving

19 Treas. Reg. § 1.507-1(c)(2).

20 *Thorne v. Comm'r.*, 99 T.C. 67, 108-109 (1992). In particular, the court found that the trustee engaged in "willful conduct" by knowing that certain procedures should be followed but not requiring them to be followed. Also, the court found that the trustee did not act reasonably by relying on oral assurances of his tax advisor after he received a notice of deficiency. Furthermore, making grants to himself and trustees' family members for their own travel to conferences was seen as a gross violation.

21 A bill has been introduced in the House and Senate that recommends a stricter standard for defining flagrant conduct. The proposed definition includes: "(A) the filing of a fraudulent return by the taxpayer, or (B) that the taxpayer acted with the intent to evade or defeat any tax imposed by this title or the collection or payment thereof." Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Right Act of 2015, H.R. 4128, 114th Cong. § 307 (2015). For more information on the bill, see Senator Ben Cardin, *Cardin and Becerra Introduce Plan to Protect Taxpayers' Rights*, *available at* http://www.cardin.senate.gov/newsroom/press/release/cardin-and-becerra-introduce-plan-to-protect-taxpayers-rights.

22 IRM 5.11.6.2(6) (Sept. 26, 2014). TAS is working with the IRS to revise this IRM section. However, no changes have been made at this time.

23 5 U.S.C. § 8432(b)(2)(A). *See also* Thrift Savings Plan, *Summary of the Thrift Saving Plan* 2, *available at* https://www.tsp.gov/PDF/formspubs/tspbk08.pdf (last visited Dec. 4, 2015).

24 *See* Thrift Savings Plan, *Summary of the Thrift Saving Plan* 2, *available at* https://www.tsp.gov/PDF/formspubs/tspbk08.pdf (last visited Dec. 4, 2015).

25 Automatic enrollment in 401(k) and similar plans was one of the most highly touted changes in the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006).

for retirement.[26] Without a definition for flagrancy and an inquiry into whether the taxpayer voluntarily committed a gross violation, the IRS employee could find flagrancy where there was an unconscious and involuntary, or unknowing violation. This means the IRS could be reducing a taxpayer to poverty in retirement because of an involuntary or unknowing act.

Finally, these examples seem counterintuitive in light of the IRS's public guidance providing safe harbors related to automatic contribution features for retirement plans.[27] If voluntarily contributing to a retirement account remains an element of flagrancy, taxpayers should at least be notified and given the opportunity to cease voluntary contributions prior to a levy on their retirement account.

Another example of flagrant conduct includes taxpayers who have demonstrated a "pattern of uncooperative or unresponsive behavior," which includes, "failing to meet established deadlines, failing to attend scheduled appointments, failing to respond to revenue officer attempts to contact."[28] This guidance does not contain any definitive deadlines and is based on a subjective determination by an IRS employee. For instance, one employee may determine that if a taxpayer is 30 days late in submitting documentation, then the taxpayer has been uncooperative, whereas another employee may consider a taxpayer uncooperative after 60 days.

Additionally, while the IRM does address extenuating circumstances that may exist to mitigate a taxpayer's behavior, it does not contain any examples of such extenuating circumstances. Nor does the IRM require the IRS employee to identify the mitigating circumstances, which could include IRS delays and IRS failures to meet appointments or take promised actions. As a result, this IRM is a trap for unwary taxpayers who may experience significant and irreparable harm as a result of a subjective and non-uniform finding of flagrancy by an IRS employee.

There Is Inadequate Instruction for Analyzing Future Retirement Calculations and No Requirement to Provide Those Calculations to the Taxpayer

The last step in determining if a levy on a retirement account is appropriate is to determine if the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[29] To conduct this analysis, employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to establish necessary living expenses and the life expectancy tables in Publication 590-A, *Individual Retirement Arrangements (IRAs)*, to estimate how much can be withdrawn annually to deplete the retirement account in the taxpayer's remaining life.[30]

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26 Congress has focused its efforts on improving retirement savings for Americans. Senator Orrin Hatch recalled in 2014 that, "[t]he retirement policies we have pursued have always been about helping Americans help themselves save more of their hard-earned money, not less." *Retirement Savings 2.0: Updating Savings Policy for the Modern Economy, Hearing Before the Committee on Finance*, 113th Cong. (Sept. 16, 2014) (statement of Orrin Hatch, ranking member, Committee on Finance).

27 Rev. Proc. 2015-28. In response to the issuance of this published guidance, Senator Ron Wyden, Finance Committee ranking member, applauded administration efforts claiming, "[t]hese improvements from the Treasury and the IRS mark an important step in helping millions of Americans save for a secure retirement. Automatic enrollment in retirement plans is a promising method to increase retirement savings. The changes made today will make it easier for smaller businesses to set up a retirement plan with automatic enrollment features and help more middle-class Americans prepare for retirement." Senator Ron Wyden, *Wyden Applauds Administration Efforts to Improve Retirement Saving* (Apr. 2, 2015) *available at* http://www.finance.senate.gov/newsroom/ranking/release/?id=3daed452-120a-45ab-b5fd-a9a4e21c05f4.

28 IRM 5.11.6.2(6) (Sept. 26, 2014).

29 IRM 5.11.6.2(7) (Sept. 26, 2014). Employees are instructed not to levy on the retirement account if it is determined that the taxpayer depends on the money in the retirement account (or will in the near future). *Id*.

30 IRM 5.11.6.2(7) (Sept. 26, 2014). When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

While the guidance refers the employee to IRM 5.15 to determine necessary living expenses, there is no discussion on determining the taxpayer's potential retirement income. Additionally, there is no requirement to document the actual calculations, making it impossible to verify that a consistent method is used in all retirement levy cases. The financial analysis handbook does not take into account cost of living increases or adjustments for increased expenses due to advanced age, such as rising health care or hospice costs. Finally, the guidance lacks a safeguard that if the IRS determines a 50-year-old taxpayer does not currently rely on the retirement account (and will not rely on it in the near future), the taxpayer has sufficient opportunity to rebuild the retirement account back up to a level that provides for a stable retirement.

> **Example:** Assume a taxpayer is 50 years old, expects to retire at age 62, and has a $40,000 tax liability with $54,000 in his TSP account. Further assume the taxpayer will begin receiving $2,000 per month from his federal pension and another $1,200 per month from Social Security at age 62, with a life expectancy of 80. The $54,000 TSP corpus (the years from the taxpayer's retirement age of 62 to 80) divided by 18 years leaves an average of $3,000 per year, or $250 per month. Thus at age 62, the taxpayer expects to have $3,450 of monthly income from all sources ($2,000 pension, $1,200 Social Security, $250 TSP). The IRS estimates the taxpayer will have necessary living expenses of $3,300 per month at retirement. Based on this financial analysis, if the IRS were to levy the entire TSP corpus, the taxpayer's monthly retirement income would be reduced to $3,200, and he could not meet his necessary living expenses of $3,300. An IRS levy should be limited to 60 percent of the TSP corpus, or $32,400, based on the crude estimate that the taxpayer would need to rely on only 40 percent of his TSP to cover necessary living expenses ($100 out of an available $250 per month). However, there are currently no safeguards to prevent the IRS from levying the *entire* TSP corpus, regardless of whether it would leave the taxpayer unable to meet necessary living expenses upon retirement.

IRM 5.11.6.2(7) does not instruct employees to provide the basis of a decision or calculations to the taxpayer. Without this information, the taxpayer cannot substantively address the IRS's determination to proceed with the levy. The IRS should consider the impact of the levy on the taxpayer's retirement security, including estimating future retirement income if the account were levied. This could be done by utilizing the Social Security Administration (SSA) and TSP websites and online calculators.[31] Alternatively, the IRS could create its own calculators for this purpose.

The IRS Does Not Educate the Taxpayer About What to Do to Avoid a Levy, or Discuss Alternative Collection Options With the Taxpayer Prior to a Levy on the Retirement Account

The current IRM guidance does not require employees to educate the taxpayer as to what he or she needs to do to avoid a levy on their retirement account. Since this levy can cause irreparable harm to the taxpayer's future well-being, it is imperative that the IRS adheres to the taxpayer *right to be informed*. As stated above, an unsophisticated taxpayer who is unaware of the IRM examples regarding flagrant conduct may continue making voluntary contributions to a retirement account, risking his or her retirement assets. The IRS would not tell the taxpayer to stop or reduce contributions to avoid being deemed flagrant, even

31 There are tools publicly available to help taxpayers estimate their retirement earnings. The IRS could use such tools to compute an estimate of benefits. For instance, the SSA provides an online tool to estimate Social Security retirement benefits. *See* SSA, *Retirement Estimator, available at* https://www.ssa.gov/retire/estimator.html. The TSP website offers an online calculator to figure out how a TSP contribution will affect account savings over time. *See* TSP, *Paycheck Estimator, available at* https://www.tsp.gov/PlanningTools/Calculators/paycheckEstimator.html.

when contributions are automatically made as a part of employment. For the government to encourage retirement contributions, but also deem those contributions as flagrant conduct, without notice to the taxpayer, is a Catch-22 for the taxpayer.

Likewise, the IRS is not proactively informing taxpayers about the tax consequences of a distribution from the retirement account. Pursuant to IRC § 408(d), generally the entire amount paid from a retirement account or any distribution is considered gross income and subject to taxation. In the instance of a levy on a retirement account, the payor would generally be required to withhold ten percent for federal income taxes.[32] It is not guaranteed that the withheld amount will cover the full amount of federal tax liabilities associated with a distribution. No amount is required to be withheld for state income taxes, which could potentially subject the taxpayer to state tax penalties and enforcement activities. These tax consequences could exacerbate the taxpayer's existing financial difficulties by creating a new tax liability the taxpayer is unable to pay, creating a vicious circle of noncompliance.

Without a definition for flagrancy and an inquiry into whether the taxpayer voluntarily committed a gross violation, the IRS employee could find flagrancy where there was an unconscious and involuntary, or unknowing violation. This means the IRS could be reducing a taxpayer to poverty in retirement because of an involuntary or unknowing act.

Educating taxpayers about tax consequences of contributions to and distributions from a retirement account is necessary for fair and just tax administration given public policy to encourage retirement savings. Moreover, communication with the taxpayer about the consequences of a levy on a retirement account (including the loss of retirement savings) might be the one piece of information that could transform a heretofore unresponsive taxpayer into a responsive and cooperative one. Thus, communication can help collect revenue *and* protect retirement savings.

Finally, the IRM makes only minimal mention of collection alternatives. The pertinent section reads: "[i]f there is property other than retirement assets that can be used to collect the liability, or if a payment agreement can be reached, consider these alternatives before issuing a levy on retirement accounts. Also consider the expense of pursuing other assets as well as the amount to be collected."[33] This excerpt only minimally references installment agreements and does not mention currently not collectible status or offers in compromise.[34] Without this information, employees may be guided to focus on the retirement account levy without considering less intrusive alternatives, thereby compromising a taxpayer's *right to privacy*.

32 IRC § 3405(b)(1). The payor generally is responsible for making this withholding, but the plan administrator may be liable in the case of certain plans. IRC § 3405(d)(1).

33 IRM 5.11.6.2(4) (Sept. 26, 2014).

34 When a taxpayer has no assets or income which are, by law, subject to levy, or it is determined that levy action would create a hardship, the liability may be reported as currently not collectible. A hardship exists if the levy action prevents the taxpayer from meeting necessary living expenses. IRM 1.2.14.1.14, *Policy Statement 5-71* (Nov. 19, 1980). *See also* Treas. Reg. 301.6343-1(b)(4). An offer in compromise allows the IRS and the taxpayer to settle an outstanding liability for a reduced amount. IRC § 7122.

The IRS Does Not Conduct a Risk Analysis Similar to the Pre-Seizure and Pre-Levy Considerations

As mentioned above, levies on retirement accounts receive "special" consideration. However, the IRS must perform a general risk analysis prior to seizing a taxpayer's property.[35] A risk analysis should also be required for levies on retirement accounts. The guidance under IRM 5.11.6.2 should also make a cross-reference to IRM 5.11.1.3.1, in which IRS employees are instructed to consider the following prior to imposing a levy:

- The taxpayer's financial condition, including information discussed in IRM 5.1.12.20.1.1 related to economic hardship determinations;
- The taxpayer's responsiveness to attempts at contact and collection;
- The taxpayer's filing and paying compliance history;
- The taxpayer's effort to pay the tax; and
- Whether current taxes are being paid.[36]

This guidance includes a clear reference to economic hardship, which the guidance for retirement levies does not include. Consideration of the taxpayer's recent filing and payment compliance history could be a mitigating factor against a determination of flagrancy. Additionally, IRS employees are instructed to consider the timing of successive seizures to avoid undue hardship and collection alternatives in order to determine the feasibility of a seizure.[37] These considerations allow for greater protection of taxpayer rights and should be incorporated into guidance for retirement levies. Finally, the IRM should require that the levy take place within a reasonable amount of time (*e.g.*, 90 days) of when the risk analysis is completed to avoid a situation of changed circumstances.

The IRS Does Not Track Levies That Are Issued Against Particular Retirement Accounts and Therefore Is Unable to Conduct Quality Reviews to Ensure Taxpayers Are Being Treated Uniformly and That the Guidance Is Being Followed By Employees

The IRS does not have a system for tracking levies that are issued against particular retirement accounts.[38] This means that IRS management and other stakeholders are not able to conduct quality reviews or track retirement levies to ensure that taxpayers are being treated in a uniform manner and that the internal guidance is being followed by employees.[39]

35 IRM 5.10.1.3.2, *Alternative Methods of Collection* (Aug. 4, 2014). There is no legal distinction between a levy and a seizure. Generally, if the taxpayer is holding the property, or a third party is holding the property and it cannot be turned over by writing a check, the IRS will use seizure procedures. IRM 5.11.1.2.2, *Notice of Levy vs. Seizure* (Aug. 1, 2014). A levy is often used for things such as a taxpayer's bank account, wages, or other income. *Id*.

36 IRM 5.11.1.3.1, *Pre-levy Considerations* (Aug. 1, 2014).

37 IRM 5.10.1.1 (Aug. 4, 2014).

38 IRS response to a TAS information request (May 21, 2015).

39 For information about how the inconsistent use of Designated Payment Codes reduces the ability to assess Collection actions, see Most Serious Problem: *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, infra.*

However, TAS conducted a review of cases from FY 2014 and FY 2015 that were most likely to contain TSP, IRA, or retirement account levies.[40] TAS reviewed 43 possible TSP levy cases and found that in 33 cases, Form 668A, *Notice of Levy*, was generated and issued to the TSP board. In 31 of those cases, the IRS employee did not document managerial approval, as required by the IRM. Additionally, flagrant conduct, a prerequisite for the levy determination, was only recorded in one case. No taxpayers were informed that making contributions could be deemed flagrant conduct. The total amount of levy funds received from these levies totaled approximately $49,000.

TAS also reviewed 128 possible IRA levy cases and found that in 72 cases, Form 668A, *Notice of Levy*, was generated and issued on an IRA account. In 52 of those cases (72 percent), the IRS employee did not document managerial approval, as required by the IRM. Flagrant conduct was documented in 18 cases and the IRS educated just one taxpayer on the effects of continuing to make IRA contributions. The total amount of levy funds received from these levies totaled approximately $2 million.

Last, TAS reviewed 176 possible retirement account levy cases and found that in 66 cases, Form 668A, *Notice of Levy*, was generated and issued on a retirement account. In 29 of those cases (44 percent), the IRS employee did not document managerial approval, as required by the IRM. The IRS documented flagrant conduct in 20 cases and the IRS informed only two taxpayers about the consequences of continued contributions. The total amount of levy funds received from these levies totaled approximately $7.6 million. It is important to make sure that each taxpayer's case receives proper analysis prior to levying on a retirement account, because proceeds from a levied retirement account cannot be returned to the retirement account, even in the event of an erroneous or wrongful levy.[41]

Even With Inadequate Guidance, the IRS Proposes a Pilot Project Within the Automated Collection System, Which Will Compound the Harm to Taxpayers

Considering all of the deficiencies discussed above, the National Taxpayer Advocate is especially concerned with the IRS's pilot program aimed at allowing its ACS to issue levies on TSP accounts.[42] This pilot will treat taxpayers with TSP accounts disparately from taxpayers who have other types of retirement accounts. If a taxpayer has a defined benefit plan and has no present right to withdraw the account balance, the IRS will have no corpus to levy upon at the present time. However, recent changes in the TSP regulations allow a levy on a TSP account to reach up to the entire vested account balance now without restrictions.[43] The IRS has not articulated a reason why it believes this pilot should single out TSP

40 TAS review completed November 17, 2015, on potential retirement account asset levy cases with levies issued between FY 2014 and FY 2015. Note: Because some taxpayers received more than one levy, the total number of cases could be slightly higher than the total number of taxpayers in the review. This review was based on a non-random sample so statistics based on this data may not project to the overall population; however the sample demonstrates that the IRS is not always following necessary procedures.

41 The National Taxpayer Advocate recommended legislative changes to IRC § 401 (for Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans), IRC § 408 (for IRA and SEP-IRAs), and IRC § 408A (for Roth IRAs) to authorize the reinstatement of funds to retirement accounts and other pension plans where the IRS levied upon the plans in error or in flagrant disregard of established IRS rules, procedures, or regulations and the funds were returned under IRC § 6343(d). National Taxpayer Advocate 2001 Annual Report to Congress 202-09. 5 C.F.R. § 1653.36(g) states that distributions made to satisfy an IRS levy may not be returned to a participant's TSP account.

42 ACS is a computerized system that maintains balance-due accounts and return delinquency investigations. IRM 5.19.5.2, *What Is ACS?* (Aug. 20, 2013). TSP is a retirement plan for federal employees established under 5 U.S.C. § 8437.

43 5 U.S.C. § 8473(e)(3), 5 C.F.R. § 1653.35, and IRM 5.11.6.2.1, *Thrift Savings Plan* (July 17, 2015).

accounts.[44] As of December 31, 2014, there are approximately 4.7 million TSP participants, so the pool of taxpayers affected by this pilot could be quite large.[45]

TAS was not consulted during the process to create procedures for this pilot, but is providing comments to the draft procedures. As currently written, the procedures provide even fewer safeguards to taxpayer rights than the current IRM guidance for levying on retirement accounts generally.[46] For instance, the procedures treat taxpayers in ACS differently from taxpayers working with a revenue officer.[47] Under the pilot procedures, the IRS employee's financial analysis will be restricted to these two elements:

- Document if there is any information that retirement is impending and that the taxpayer will be relying on funds in the TSP for necessary living expenses. The employee is instructed to use available information to apply the standards in IRM 5.19.13.1.4 and Publication 590-A. If this documentation is present, do not issue the TSP levy; and
- Also, consider any special circumstances in the taxpayer's situation, such as extraordinary expenses, or additional sources of income, including spousal income and assets, other retirement accounts, etc. that will be available to pay expenses during retirement.[48]

There is no mention of reviewing IRM 5.15, *Financial Analysis*. Furthermore, these procedures introduce considerations not found in IRM 5.11.6.2(7), such as imputing spousal income into the financial analysis.[49] TAS is working actively to address the problems with the pilot.

Under ACS, cases are assigned to teams, functions, or units rather than individual employees.[50] It is a computer system that "analyzes for levy sources, undeliverable mail codes, telephone numbers, and other characteristics" in place of an employee. The computer system also "prints letters for mailing and assigns cases to the proper team, function, or units," while a "small percentage of cases meeting specific criteria" are researched by the ACS Support function.[51] ACS provides minimal contact with a taxpayer. For instance, ACS uses "predictive dialer" technology, which automatically makes outbound calls to taxpayers or representatives and if contact is made, the call is transferred to a waiting agent.[52] Last, correspondence

44 In response to an information request asking for the rationale of the pilot program, the IRS explained that "ACS has authority to issue levies on retirement accounts, however, it was not previously utilized. The pilot is an opportunity to determine if this means will be cost effective and meet sound tax administration." IRS response to TAS information request (July 9, 2015).

45 Thrift Savings Fund, *Financial Statements December 31, 2014 and 2013* 6, *available at* http://www.frtib.gov/ReadingRoom/FinStmts/TSP-FS-Dec2014.pdf.

46 IRS, *ACS Thrift Savings Plan Levy Pilot Procedures* (Dec. 9, 2015).

47 *Id*.

48 *Id*.

49 *Id*.

50 IRM 5.19.5.3, *Research on ACS* (Jan. 6, 2015).

51 *Id*.

52 IRM 5.19.5.4.1(1) (Feb. 20, 2015). An automated message is left if an answering machine answers and if there is no answer, the system "updates the account and reschedules the case to the predictive dialer queue for another attempt." *Id*.

submitted by a taxpayer to ACS is actually processed by ACS Support, a different unit.[53] The IRS has confirmed that the ACS pilot will work in a similar fashion.[54]

The taxpayer may struggle to navigate a system in which they receive automated phone contact, but cannot contact an assigned employee.[55] With no employee assigned to the case, each contact or piece of correspondence would be analyzed by a different employee. The National Taxpayer Advocate is concerned that under this system the ACS employee will not be able to make a determination of flagrancy under the proposed definition. As mentioned above, IRM 5.11.6.2.1(5) requires that the IRS employee prepare written analysis for the manager to approve prior to levy. This analysis requires that the employee consider the taxpayer's current situation, his or her conduct, and any mitigating circumstances, as well as the taxpayer's projected economic viability. The National Taxpayer Advocate provided training to the employees assigned to the pilot cases. However, even with training, the minimal contact associated with ACS will make it difficult, if not impossible, for ACS employees to make these determinations accurately. It does not appear the ACS manager will have much information about the taxpayer's financial condition or extenuating circumstances before giving rote approval to a levy that could potentially destroy a taxpayer's retirement income security.

Educating taxpayers about tax consequences of contributions to and distributions from a retirement account is necessary for fair and just tax administration given public policy to encourage retirement savings.

Furthermore, the reach of a TSP levy is far more expansive than the levy on a non-TSP retirement account. As discussed above, the levy on a non-TSP retirement account generally only reaches the assets over which the taxpayer has a present withdrawal right. However, recent changes in the law and regulations written by the Federal Retirement Thrift Investment Board that manages TSP accounts, allow a TSP levy to reach up to the vested account balance.[56] Thus, the IRS can levy upon the *entire vested balance* of the TSP account, even if the participant has no current right to access the funds.[57] As a result, a levy on a TSP account could be even more damaging to a taxpayer than a levy on a non-TSP retirement plan (*e.g.*, 401(k) plans). This greater risk of harm should cause the IRS to provide more taxpayer rights protections rather than less. Retirement levy determinations should require assignment to employees with the skills, training, and resources required to ensure appropriate and consistent application of retirement levies.

53 IRM 5.19.6.1, *ACS Support Overview/What Is ACS Support* (June 17, 2014). ACS Support is experiencing a backlog of work and in response the IRS recently announced that ACS Support will, among other things, cease processing paper third-party levy responses in order to address taxpayer correspondence. This deviation will occur until the end of September 2015. Memorandum to Campus Collection Directors from DelRey Jenkins, Director, Campus Collection, *Deviation Authority to Discontinue the Processing of ACS Support (ACSS) Levy Responses* (Mar. 23, 2015).

54 Two or more employees will be designated to work the pilot inventory. The cases will not be assigned to a specific employee. The lead who receives the case will complete the investigation and will make a levy determination if appropriate. If a taxpayer calls in response to the levy, the ACS employee will prepare Form 4442, *Inquiry Referral*, to the levy originator and advise the taxpayer that they will be contacted by the levy originator within 24 hours. IRS, *ACS Thrift Savings Plan Levy Pilot Procedures* (Dec 9, 2015). Any taxpayer correspondence will be routed to the designated leads. IRS response to TAS information request (July 6, 2015).

55 For information on how the lack of an assigned employee can affect taxpayers under correspondence examination, an automated system for examinations, *see* National Taxpayer Advocate 2014 Annual Report to Congress 134-44. This situation is also made worse by the fact that the level of ACS customer service has decreased. Treasury Inspector General for Tax Administration (TIGTA) determined that ACS has answered 25 percent fewer calls even though total calls into the ACS unit have decreased 16 percent since FY 2011. TIGTA, Ref. No. 2015-30-035, *Reduced Budget and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected* 10 (May 2015).

56 5 U.S.C. § 8437(e)(3) and 5 CFR § 1653.35.

57 IRM 5.11.6.2.1(1) (July 17, 2015).

CONCLUSION

Current internal guidance does not ensure that a taxpayer's unique facts and circumstances will be considered prior to levy of his or her retirement account and does not fully recognize the importance of retirement savings. It also disregards the balance between the need for enforcement to be no more intrusive than necessary. Without clear guidance, the IRS employee's determination is subjective and susceptible to personal judgment. This could lead to inconsistent treatment of similarly situated taxpayers, which could erode taxpayers' confidence in a fair tax system and decrease voluntary compliance. Moreover, a taxpayer cannot adequately challenge the decision to levy without being provided a detailed analysis of the basis for levy, a situation which impacts the taxpayer's *right to challenge the IRS's position and be heard*. Last, without clear guidance, taxpayers do not know what they need to do to comply with tax laws, which diminishes the *right to be informed*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, revise the IRM on retirement account levies to define flagrant conduct, which should include elements of willful and voluntary conduct that appears to be a gross violation from a reasonable person standard, include examples of extenuating circumstances that can mitigate flagrant conduct, require a full pre-levy financial analysis, and educate taxpayers about actions available to avoid a levy on a retirement account.
2. The IRS should identify calculators that it can use, such as those provided by the SSA or TSP, to determine the impact of a levy on a retirement account on the taxpayer's future well-being. Alternatively, the IRS could create its own calculator.
3. Create a unique Designated Payment Code for retirement levy proceeds or a unique identifier within the Integrated Collection System to identify, track, and review retirement levy cases.
4. 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

RESPONSIBLE OFFICIALS

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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Notices of Federal Tax Lien (NFTLs) establish priority of the government's interest in a tax debtor's property with respect to certain creditors by putting the public, including third-party creditors, on notice of an existing statutory lien.[2] 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.[3] NFTLs also generate significant downstream costs for the government, often without attaching to any tangible assets.[4] The IRS files most NFTLs based on an arbitrary dollar threshold of the unpaid liability, with over 21 percent of NFTLs filed without human involvement in determining lien filings,[5] rather than 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. 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 the NFTL filing.[6]

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Internal Revenue Code (IRC) §§ 6321, 6322, and 6323(a).

3 In fiscal years (FYs) 2009-2012, TAS Research & Analysis investigated the IRS's use of NFTLs and their impact on the compliance behavior of delinquent taxpayers. *See* National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 105-30 (TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact on Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 89-100 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Study: *The IRS's Use of Notices of Federal Tax Lien*).

4 *See* T. Keith Fogg, *Systemic Problems with Low-Dollar Lien Filing*, 2011 TNT 194-9 (Oct. 6, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices Are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*).

5 IRS Collection Activity Report (CAR), NO-5000-25, *Lien Report, September, FY 2015*. In FY 2015, there were 515,247 liens filed, including 4,918 refiled liens, with 202,127 arising in the Automated Collection System (ACS). Approximately 47 percent, of ACS NFTLs are filed manually. Small Business/Self-Employed (SB/SE) response to TAS information request (Oct. 19, 2015); IRS CAR, NO-5000-25, *Lien Report, September, FY 2015.*

6 IRS Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015) (specifying that 37 percent level of service for the installment agreement line).

The National Taxpayer Advocate has repeatedly expressed concerns regarding the negative impact of the IRS's NFTL filing policies on taxpayers and on future compliance.[7] The IRS can significantly increase the effectiveness of NFTL filings without needlessly harming taxpayers by replacing the current policy with a cost-efficient algorithm for making NFTL filing determinations incorporating:

- meaningful contact with the taxpayer to obtain financial information and establishing a payment plan;
- thorough analysis of the taxpayer's financial situation, including whether the NFTL will attach to tangible property; and
- the impact of the NFTL on future compliance.

ANALYSIS OF PROBLEM

Background

The IRS's ability to file a NFTL, which protects the government's interest in property against subsequent purchasers, secured creditors, and junior lien holders, is a power unlike that of other creditors, since the IRS does not need to obtain a judgment to file a NFTL.[8] The filing of a NFTL can significantly damage the creditworthiness of a taxpayer, which can negatively impact the ability to obtain financing for a home or other major purchases, find or maintain a job, secure affordable rental housing or insurance, and pay the tax debt.[9]

Congress recognized the unique nature of a NFTL and, when enacting the IRS Restructuring and Reform Act of 1998 (RRA 98), it precluded the IRS from "abusively us[ing] its liens and seizure authority."[10] Upon assessment of a tax liability, notice to the taxpayer, demand for payment, and the taxpayer's failure to pay, a lien in favor of the United States attaches to the taxpayer's property.[11] This statutory lien, known as a "secret lien" because the taxpayer does not usually know it has arisen, attaches to all of the taxpayer's property and rights to property, both real and personal, and to any future property acquired by the taxpayer.[12] However, this "secret lien" does not provide the IRS with priority over other creditors that do not have actual knowledge of the secret lien; thus, the IRS must file an NFTL to establish priority of the

7 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 225-36 (Most Serious Problem: *Managerial Approval for Liens: The IRS's Administrative Approval Process for Notices of Federal Tax Liens Circumvents Key Taxpayer Protections in RRA 98*); National Taxpayer Advocate 2012 Annual Report to Congress 403-25 (Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices Are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*).

8 IRC §§ 6321, 6322, and 6323(a).

9 *See* National Taxpayer Advocate 2014 Annual Report to Congress 225; *see also* Heather Struck, *A Bad Credit Score Affects a Lot More Than Credit*, Forbes, Jul. 20, 2011, *available at* http://www.forbes.com/sites/heatherstruck/2011/07/20/credit-score-fico-can-hurt-you/; written response from Vantage Score® (Sept. 17, 2009).

10 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998). *See also* S. Rep. No. 105-174, at 78 (1998); Unanimous Consent Request – H.R. 26767, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

11 IRC §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed, and IRC § 6303 provides that within 60 days of the assessment, the IRS must provide notice and demand payment to any taxpayer liable for an unpaid tax.

12 *Id*. Internal Revenue Manual (IRM) 5.12.1.3, *Creation and Duration* (Oct. 14, 2013). The NFTL is effective as of the date of assessment and continues until the liability is either paid in full or is legally unenforceable. The IRS must release the lien within 30 days after the underlying liability is satisfied or becomes legally unenforceable. IRC § 6325(a)(1). Because the NFTL is a statutory lien — or "secret" lien — third parties have no knowledge of the existence of the underlying debt. IRC § 6321.

The filing of a Notice of Federal Tax Lien (NFTL) can significantly damage the creditworthiness of a taxpayer, which can negatively impact the ability to obtain financing for a home or other major purchases, find or maintain a job, secure affordable rental housing or insurance, and pay the tax debt.

government's interest in the property against subsequent purchasers, secured creditors, and junior lien holders.[13]

In 2011, in response in part to the National Taxpayer Advocate's continued concern over NFTL filing and withdrawal policies, the IRS announced a new effort to help financially struggling taxpayers get a "fresh start."[14] The "Fresh Start Initiative" resulted in several positive changes in how the IRS files and withdraws NFTLs, including increasing the Automated Collection System (ACS) NFTL filing threshold from $10,000 to $25,000.[15] However, the IRS continues to file NFTLs automatically based on that threshold, with little management review and without attempting meaningful contact with a taxpayer, doing a financial analysis, or considering the impact on future compliance.[16]

Current NFTL Filing Policy Is Based on an Arbitrary Dollar Threshold of the Unpaid Liability Rather Than Focused on Meaningful Contact with the Taxpayer

As stated above, the IRS generally files NFTLs if the aggregate unpaid balance of assessment is over $10,000, or for accounts in ACS, if the assessment is over $25,000.[17] Contrary to congressional intent, only the decision to *not* file an NFTL requires managerial approval in most circumstances.[18] Prior to the filing of an NFTL, the IRS must make "reasonable efforts" to contact the taxpayer to "advise [the taxpayer] that an NFTL may be filed if full payment is not made when requested."[19] However, the Internal Revenue Manual (IRM) provides that "reasonable effort" includes "issuance of the statutory assessment notices and the balance due notices sent during

13 *See* IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.1.4, *Purpose and Effect of Filing a Notice of Federal Tax Lien (NFTL)* (Oct. 14, 2013). The IRS must file the NFTL in the correct county or jurisdiction where the taxpayer's property is located.

14 IRS, Media Relations Office, *IRS Announces New Efforts to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process*, IR-2011-20 (Feb. 24, 2011).

15 National Taxpayer Advocate 2012 Annual Report to Congress 408. The IRS implemented this change through a policy decision that reprogrammed ACS to file NFTLs only where the unpaid balance of assessment is over $25,000. However, the IRS did not update the IRM or issue interim guidance reflecting this change.

16 National Taxpayer Advocate 2014 Annual Report to Congress 225-36 (Most Serious Problem: *Managerial Approval for Liens: The IRS's Administrative Approval Process for Notices of Federal Tax Liens Circumvents Key Taxpayer Protections in RRA 98*).

17 *See* IRM 5.12.2.6(1) (Oct. 14, 2013); IRM 5.19.4.5.3, *NFTL Filing Decisions* (Aug. 4, 2014); *see also supra* note 15 (noting that the $25,000 threshold is not listed in the IRM nor in interim guidance but is an established policy decision); SB/SE response to TAS information request (June 10, 2015) (stating that on April 15, 2011, the "ACS Systemic Lien threshold was increased to $25,000").

18 National Taxpayer Advocate 2014 Annual Report to Congress 226, 229. As described in the 2014 Annual Report, despite the congressional direction that the IRS adopt procedures in which an employee's determination to file a NFTL would, "where appropriate," be approved by a supervisor in RRA 98 § 3421, the IRS's current policy is to only have those reviews take place when the determination is to *not* file a NFTL or if the Revenue Officer is below a full performance level of GS-9. *See* RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998); Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding that RRA 98 § 3421 does not require supervisory review of all collection actions but allows the IRS the discretion to determine where such review would be appropriate); IRM 5.12.2.5.2(1) (Oct. 14, 2013). Furthermore, IRM 5.12.2.5.3(2) (Nov. 9, 2015) provides that managerial approval is required for the *non*-filing or deferral of an NFTL filing when the "known aggregate assessed or to be assessed balance will be greater than $10,000," there are ten or more modules open, or the "NFTL filing is deferred or not filed for more than 120 days from initial or last [taxpayer] contact," including "situations when the Revenue Officer is waiting for either actions by or documentation from a taxpayer." The only exceptions to managerial approval are limited to cases in which the balance is less than $2,500, there has previously been a non-filing or deferral approval in the case and circumstances remain the same, the case meets the Streamline Installment Agreement criteria under IRM 5.14.5.2, or the case meets the criteria for specifically not filing an NFTL under IRM 5.12.2.4.2(2) or 5.12.2.4.2(3). IRM 5.12.2.5.3(1) (Nov. 9, 2015).

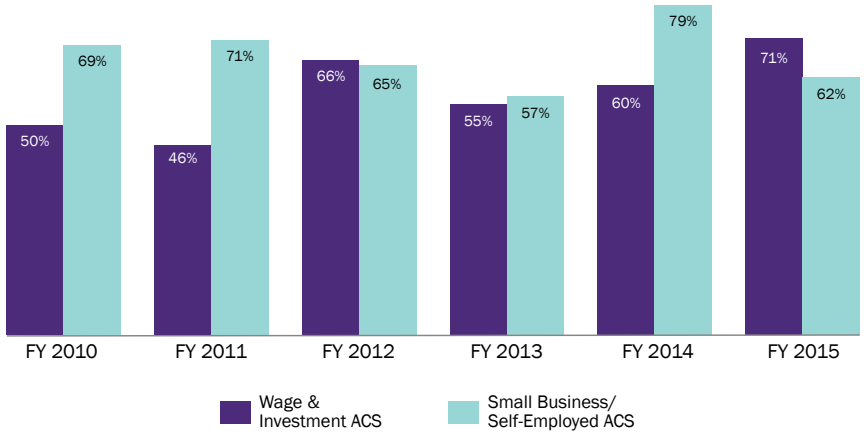
19 IRM 5.12.2.2(1) (Nov. 9, 2015).

the collection process ….”[20] This guidance suggests the IRS is simply “checking the box” on contacting taxpayers without actually attempting meaningful contact to resolve the tax liability.

Under current procedures, the request for an NFTL filing or the appropriate non-filing documentation must be prepared within ten calendar days of the initial attempted contact or the initial actual contact with the taxpayer or his or her representative.[21] A “contact,” as defined in the IRM, is made by either a field contact, the preferred method for Revenue Officers; a telephone call; or mailing a notice or letter to the taxpayer’s last known mailing address.[22] As Figure 1.11.1 below illustrates, a majority of these attempted telephone calls by ACS using predictive dialers do not result in actual contact with the taxpayers.[23]

FIGURE 1.11.1[24]

Percentage of Predictive Dialer Outbound Calls in the Automated Collection System (ACS) That Resulted in “No Contact”



This ten-day timeframe is an incredibly short period to allow any “meaningful contact” to occur, let alone enable the taxpayer to provide the IRS with a clear picture of his or her current financial situation. The IRS does not take into account the amount of time it takes for the taxpayer to contact the IRS and gather and send the necessary financial information or for the IRS to process and deliver that information.[25]

20 IRM 5.12.2.2(1) (Nov. 9, 2015).

21 IRM 5.12.2.3.2(1) (Oct. 14, 2013). The NFTL determination is separate from the NFTL filing consideration. The ten-day pre-filing consideration is a process of deciding whether to file, defer, or not file, an NFTL. IRM 5.12.2.3(1) (Oct. 14, 2013).

22 IRM 5.12.2.2(2) (Nov. 9, 2015). The IRS does not systemically track how often each “contact” method is utilized. *See* SB/SE response to TAS information request (Nov. 6, 2015).

23 SB/SE response to TAS information request (June 10 and Oct. 19, 2015).

24 *Id*. This does not include the limited number of “manual outbound calls” initiated by an ACS employee working an ACS case.

25 Over half of Accounts Management correspondence inventories are in “overage,” meaning they have not been handled in the established timelines. *See* IRS, Customer Account Services Accounts Management Paper Inventory Reports, *Inventory Age Report – All Programs* (week ending Sept. 30, 2015) (noting that 54 percent of Individual Master File Correspondence is in “overage”).

And, all this assumes the taxpayer receives correspondence about the NFTL and it is not returned to the IRS as undeliverable mail.[26]

Additionally, even if the taxpayer receives a notice or a phone message and attempts to call the IRS back at the number provided on the majority of notices, it is unlikely he or she will get through to the IRS to make payment arrangements prior to going into ACS. In fiscal year (FY) 2015, the level of service (LOS) for the Installment Agreement/Balance Due phone number was less than 40 percent.[27] Because of the poor level of service on the payment phone line, the IRS may view taxpayers as being unwilling to pay when they were actually trying to reach the IRS to set up payment plans. Consequently, given the short timeframes for taxpayer response, the IRS files NFTLs against taxpayers who are trying to reach the IRS but cannot. This situation not only harms taxpayers but also erodes trust in the IRS and can undermine future compliance.

The IRS Could Learn From Meaningful Contact Practices in the Financial Industry and Other Tax Administration Agencies

The National Taxpayer Advocate has continuously discussed the importance and usefulness of meaningful contact, specifically personal contact, rather than simply mailing letters and providing taxpayers with information regarding their payment options.[28] In the private sector, creditors routinely use early intervention as a pre-collection mechanism.[29] It has become a standard in the mortgage industry for loan servicers to contact borrowers at least twice within the first 45 days of delinquency to discuss potential loss

26 *See* National Taxpayer Advocate 2013 Annual Report to Congress 157; National Taxpayer Advocate 2010 Annual Report to Congress 221-32 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

27 IRS JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015). The customer service representative (CSR) level of service for the Installment Agreement/Balance Due phone number in FY 2015 was approximately 37 percent. *Id*. Overall, taxpayers have to wait a significant amount of time on hold to actually speak with an assistor, and almost 18 million callers were disconnected via a "courtesy disconnect" message. *See* IRS, JOC, *Custom Report RRC 2015-1623* (including weekly data on the number of courtesy disconnects from FYs 2011 to 2015) (noting that 4,853,347 courtesy disconnects occurred in the "individual category" alone for FY 2015). The SB/SE ACS number, 800-829-3903, and the W&I ACS number, 800-829-7650, do have a significantly higher level of service, over 70 percent, but the taxpayer is not provided this number until after he or she has entered into ACS and the NFTL may have already been filed by ACS. IRS JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015). For ACS incoming calls in FY 2015 the average handle time was 16.2 (W&I) to 16.5 (SB/SE) minutes and an average queue time of 12.8 (SB/SE) to 14.5 (W&I) minutes. SB/SE response to TAS information request (Oct. 19, 2015).

28 National Taxpayer Advocate 2011 Annual Report to Congress 336-47 (Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 40-70 (TAS Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2008 Annual Report to Congress 114-25 (Most Serious Problem: *Navigating the IRS*); National Taxpayer Advocate 2006 Annual Report to Congress 62-82 (Most Serious Problem: *Early Intervention in IRS Collection Cases*), 83-109 (Most Serious Problem: *IRS Collection Payment Alternatives*), 110-29 (Most Serious Problem: *Levies*), 141-56 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*); National Taxpayer Advocate 2004 Annual Report to Congress 226-45 (Most Serious Problem: *IRS Collection Strategy*). The National Taxpayer Advocate has also discussed in detail the impact of future compliance with meaningful contact in her prior reports. *See* National Taxpayer Advocate 2014 Annual Report to Congress 225-35 (Most Serious Problem: *Managerial Approval For Liens: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*); National Taxpayer Advocate 2012 Annual Report to Congress 403-25 (Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*).

29 *See, e.g.*, National Service Bureau, *Pre-Collection Services (Early Intervention)*, *available at* http://www.nsbi.net/early-out-pre-collect (last visited Dec. 4, 2015).

Because of the poor level of service on the payment phone line, the IRS may view taxpayers as being unwilling to pay when they were actually trying to reach the IRS to set up payment plans. Consequently, given the short timeframes for taxpayer response, the IRS files Notices of Federal Tax Liens (NFTLs) against taxpayers who are trying to reach the IRS but cannot.

mitigation options available.[30] The Real Estate Settlement Procedures Act requires that the first contact, which must take place by the 36th day of delinquency, is a "live contact," or at least a good faith effort for live contact.[31] Furthermore, tax administration agencies around the world, including Sweden, Australia, Norway, and New Zealand, successfully use reminders, specifically "gentle" reminders, to increase tax payment compliance and prevent enforcement measures.[32] For example, New Zealand saw an increase of on-time payments by 12.6 percent between 2010 and 2013 by simply using short message service (SMS) to provide real-time reminders of key payments to a targeted group of taxpayers.[33]

Meaningful and personal contact, such as a "soft" letter followed by a telephone call, sends a timely message to a taxpayer. Often a reminder is all that is necessary to resolve past-due debts prior to placing them in full collection. It would be beneficial for the IRS, in terms of saving NFTL filing fees and promoting taxpayer rights and future compliance, to make multiple attempts to *contact* taxpayers by phone and through mailing monthly reminder notices (or SMS) instead of filing an NFTL after just one attempt. The IRS could use technology, such as a predictive dialer system, to reach taxpayers proactively and utilize third-party databases, such as *LexisNexis® Accurint*, to find alternative numbers and addresses associated with taxpayers.[34] However, given the current LOS and limited ability for taxpayers to reach the IRS via telephone, the IRS should expand the ten-day time frame to enable it to make meaningful contact with the taxpayer before making lien determinations.[35]

A Thorough Analysis of the Taxpayer's Financial Situation Is Necessary to Make an Accurate NFTL Filing Determination

NFTLs are currently filed pursuant to strict business rules as opposed to a thorough review of the taxpayer's financial situation. It was not until 2013, after consistent criticism from TAS, that the IRS added

30 The Consumer Financial Protection Bureau has incorporated the need for early contact with delinquent debtors in the 2013 updated mortgage servicing rules by requiring loan servicers to contact borrowers at least twice within the first 45 days of delinquency and discuss potential loss mitigation options available, if appropriate. *See* 12 C.F.R. § 1024.39; Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10696, 10787-10807 (Feb. 14, 2013).

31 *Id*.

32 *See* OECD, Working Smarter in Tax Debt Management 44 (2014), *available at* http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/working-smarter-in-tax-debt-management_9789264223257-en#page1. The use of reminders, specifically "gentle" reminders, has proven to be successful in increasing tax payment compliance and preventing enforcement measures in both Sweden and Australia. *Id*. Norway has seen a reduction in the need for "attachments" by 30 percent and a decrease in unsatisfied callers simply by sending gentler reminders.

33 *Id*. at Table 3.3 (2014) (stating that New Zealand saw an increase in on-time payments from 72 percent to 84.6 percent between 2010 and 2013 due to the use of SMS reminders to targeted groups of taxpayers).

34 Predictive dialer is a computer-based system that automatically dials groups of telephone numbers and then passes live calls to available CSRs. *See, e.g.*, SpitFire Predictive Dialers, *available at* http://www.tmcnet.com/channels/predictive-dialer/ (last visited Dec. 4, 2015). *See also* National Taxpayer Advocate 2012 Annual Report to Congress 526-36 (Legislative Recommendation: *Amend IRC § 7701 to Provide a Definition of "Last Known Address," and Require the IRS to Mail Duplicate Notices to Credible Alternative Addresses*); LexisNexis® Accurint, *available at* http://accurint.com/ (last visited Dec. 4, 2015). The IRM does instruct employees to "research" within 14 days to determine if there is a more current address available for reissuance of the notice. *See* IRM 5.19.6.17.4(1) (Oct. 15. 2014).

35 *See supra* note 27.

the lien determination pre-filing considerations to the IRM to assist employees in deciding whether to file an NFTL.[36] The pre-filing considerations include:

(1) the taxpayer compliance history;

(2) taxpayer qualification for a determination exception;

(3) protection of the government's interest, including exigent circumstances, where the filing of an NFTL is necessary to protect those interests; and

(4) taxpayer's qualification for a determination that a NFTL filing will hamper collection.[37]

To ensure that the IRS is balancing the need to protect the government's interest with the taxpayer's right that the collection action be no more intrusive than necessary,[38] the IRS should complete a thorough analysis of the taxpayer's financial situation when it makes a lien determination.[39] At minimum, the IRS should complete a limited analysis of the taxpayer's financial situation, using a form similar to the Form 433-F, *Collection Information Statement*, to determine if the taxpayer has assets currently or will have assets in the foreseeable future.[40] The IRS files approximately 21 percent of NFTLs automatically without human involvement in determining lien filing.[41] Even in an automated environment, it should develop an automated basic financial analysis for NFTL filing determinations, through the use of credit scoring and automated asset verification, while elevating close call or complex cases to an employee.

Using Technology and Databases to Improve Financial Analyses

The IRS is "one of the largest financial institutions in the world,"[42] but it is reluctant to implement financial analysis techniques and certain automation techniques used by modern financial institutions, including financial scoring, credit risk analysis, and modeling. Several large credit scoring and credit analysis providers offer solutions to automate collection decisions.[43] For example, *LexisNexis® RiskView™ Solutions* and *Accurint® for Collections: Decision Workflow* enables financial institutions and other creditors to access data from thousands of public sources to find court records, assets, and licenses, which can be factored into the determination of ability to repay, eligibility for a repayment plan, and recommendation of payoff amounts based on a comprehensive analysis of credit risk management data.[44] The IRS can employ new techniques, widely used in the financial industry, to automate analysis and regular monitoring of internal and external sources.

36 IRM 5.12.2.3, *Notice of Federal Tax Lien Filing Determination (Pre-filing Considerations*) (Oct. 14, 2013).

37 IRM 5.12.2.3(3) (Oct. 14, 2013). The IRM does not instruct employees to consider if the taxpayer is attempting to engage with the IRS through correspondence or phone.

38 *See* Taxpayer Bill of Rights, *The Right to Privacy*, *available at* http://www.taxpayeradvocate.irs.gov/taxpayer-rights/right-7.

39 IRC § 6320; IRM 5.12.2.3(2) (Oct. 14, 2013).

40 Form 433-F, *Collection Information Statement* (Rev. Jan. 2013), Catalog 62053J.

41 *See supra* note 5. The IRS has provided that "lien filing determinations are not tracked," and thus it is not studying the number of lien determinations that are made, and of that number, how many resulted in a lien actually being filed and the length of time between the determination and filing. SB/SE response to TAS information request (June 10, 2015).

42 IRS, *Careers Home*, *available at* http://www.jobs.irs.gov/student/accounting-budget-finance.html (last visited Dec. 4, 2015).

43 *See generally* Experian, *Financial Stability Risk Score*, *available at* http://www.experian.com/business-information/financial-stability-risk-score.html (last visited Dec. 4, 2015); Rosella, *Credit Risk Analysis and Modeling*, *available at* http://www.roselladb.com/credit-risk-analysis.htm (last visited Dec. 4, 2015); Rapid Insight® Analytics, *Predictive Modeling Software*, *available at* http://www.rapidinsightinc.com/products/analytics/ (last visited Dec. 4, 2015).

44 LexisNexis, *RiskView*, *available at* http://www.lexisnexis.com/risk/products/riskview-credit-risk-management.aspx (last visited Dec. 4, 2015); LexisNexis, *Accurint® for Collections: Decisioning Workflow*, *available at* http://www.lexisnexis.com/risk/products/collections/accurint-collections-decisioning.aspx (last visited Dec. 4, 2015).

The IRS should develop a risk-scoring algorithm for meaningful NFTL filing determinations in an automated setting and regularly update these models to reflect actual and up-to-date data. Currently, the IRS does not utilize any risk-scoring system or business rules in determining when to consider the filing of an NFTL.[45] While there would be an initial investment in terms of programming costs, it would likely result in more efficient lien filing and would save the IRS expenses associated with the filing of liens against nonexistent assets.[46]

Any such model, however, must be built based on the fundamental principal that the IRS is not a business. That is, unlike private creditors, the IRS is not able to pick and choose with whom it wants to "do business." And unlike a business, the IRS cannot solely focus on the debtor's current tax debt; it must continue "doing business" with the taxpayer from year to year.[47] Future compliance is a predominant concern for any IRS risk scoring. Finally, it is vital that any IRS risk-scoring models are constantly updated with actual taxpayer behavior data.

At the very least, the IRS could replace the mandatory NFTL filing on currently not collectible (CNC) taxpayers and on taxpayers with no assets with a system of automated subsequent filing determinations. These automated subsequent filing determinations would be based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved by developing software that can incorporate analysis of information from *Accurint*® and IRS internal databases. This type of analysis would enable the IRS to continue to protect the government's interest in any future assets without unnecessarily harming taxpayers. The IRS currently allows employees to refile a NFTL, following extension of the collection statute expiration date, using their judgment rather than an arbitrary threshold amount.[48] It could also apply this approach to the original NFTL filing.

Updating IRS e-Guides to Incorporate Basic Financial Analysis on Taxpayers Prior to NFTL

Another cost-effective way to operationalize the review of the taxpayer's financial condition, outside of the ACS lien filing, would be to update the IRS e-Guides with a series of questions determining if the taxpayer has or is likely to have assets to which a lien can actually attach.[49] The e-Guides would instruct IRS employees not to file a lien if they are unable to locate assets and to refrain from filing an NFTL within the ten-day period if no concerted effort is made to contact and speak directly with taxpayer.

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45 SB/SE response to TAS information request (Nov. 6, 2015) (stating that the IRS does not currently use any "risk-scoring system or business rules in determining when to consider filing an NFTL").

46 In FY 2015, TAS had a closure rate with relief of 65 percent (603 cases) for lien release and approximately 68 percent (629 cases) for lien withdrawal. *See* TAS Business Performance Management System Report, *Closures – TAS Relief Rate by PCIC by BOD (FYs 2010-2015)*. The IRS has not done a comprehensive study on the costs associated with filing liens, for either individuals or businesses, since 1998, and that study was limited. *See* North Central DORA, South Texas DORA, *Federal Tax Lien Project, Project 13.14, Profile Report* (Dec. 1998).

47 Unlike a private creditor, the IRS cannot decide to never lend to a debtor again.

48 Upon the collection statute expiration date, the liability secured by lien becomes legally unenforceable. *See generally* IRC §§ 6325(a)(1) and 6502(a). The NFTL contains the self-releasing language that extinguishes the NFTL and underlying statutory lien. *See* Form 668(Y)(c), *Notice of Federal Tax Lien* (Rev. Feb. 2004). If the collection statute is extended or suspended on the underlying assessment, beyond the ten-year period, the NFTL must be refiled in the original jurisdiction to keep its priority back to the original filing date. *See* IRC § 6323(g).

49 E-Guides, or "electronic procedure guides," have been developed and used by the IRS for many years. They are formal guides for IRS employees that organize the different types of important processes and procedures in an easily accessible and usable way. *See* IRM 5.19.1.1(6) (Sept. 29, 2014).

The IRS should redefine the use of a Notice of Federal Tax Lien (NFTL) as a powerful collection tool based on meaningful and early contact with taxpayers, automation of financial analysis and asset verification, and the impact of NFTL filing on the taxpayer's financial viability and future compliance.

Current Data Reveals That Early Interventions Drive the Collection of Revenue

TAS Research & Analysis is currently studying how the aging of a delinquency affects dollars collected on Taxpayer Delinquent Accounts (TDAs).[50] A study, set forth in Volume 2 of this report, examines the Individual Master File (IMF) Accounts Receivable Dollar Inventory (ARDI) to determine how dollars collected fluctuate as time elapses.[51] The study determined that collection decreases as time passes, with dollar collections of over twice as much during the first year as in the second year, and over three times the collections in the third year.[52] Furthermore, the study found that even within the first year, dollars collected decreased by about one-third after every three-month period elapsed. Not only do raw dollars collected decrease, but the percent of the amount collected declines as time progresses with only about seven percent collected in the third year.[53] This study clearly demonstrates the importance of early meaningful contact. The IRS should use the data collected by TAS Research to revise its NFTL filing policies and increase its efforts to make early and frequent taxpayer contacts.

The IRS' Lien Pilot Program May Provide Significant Evidence of What IRS Actions Result in Revenue Collection

In the summer of 2014, the IRS indicated its plan to revert back to the published NFTL filing threshold of $10,000 for ACS NFTL filings.[54] After intervention by the National Taxpayer Advocate, the IRS agreed to conduct a lien filing pilot before it makes any changes in ACS filing threshold, to determine whether lowering the ACS NFTL filing threshold to $10,000 would result in enhanced protection of the government's interest and would facilitate the collection of delinquent tax liabilities. The IRS anticipates starting the Collection Lien Pilot in February 2016. The lien pilot program could become an excellent starting point in the development of a risk-scoring algorithm for meaningful NFTL filing determinations.

The National Taxpayer Advocate has suggested that the lien pilot program focus on the use of "meaningful contact" with taxpayers prior to the filing of the NFTL, rather than just studying the impact of different dollar thresholds, and examine the impact of NFTLs on future compliance. Specifically, the National

50 *IRS Collectibility Curve*, vol. 2, *infra*. In prior Annual Reports, the National Taxpayer Advocate has discussed how many TDAs in the IRS Automated Collection Branch and the Collection Field function are often delinquencies that have existed for many years. The age of IRS TDA inventory is highlighted in the following statistics: (1) 55 percent of the IRS IMF TDA inventory has been in the function assigned the delinquency for at least ten months; however, the delinquency may have been in the TDA status much longer; (2) nearly 70 percent of the IMF TDAs in IRS inventory at the end of FY 2015 are Tax Year 2011 and prior liabilities; and (3) over 22 percent of the TDAs have less than four years remaining on the collection statute, meaning that the delinquency has existed for over six years. IRS CAR, NO-5000-5 (Oct. 3, 2015).

51 *Id.*

52 *Id.* The analysis showed that dollars collected decreased by over 50 percent from the first year to the second year and collection decreased in the third year by over 30 percent from the amount collected in the second year.

53 *Id.* Although the balance of tax due continues to decrease slightly, the amount of assessed and accrued penalties and interest continue to rise.

54 *See* email from John Dalrymple, Deputy Commissioner for Services and Enforcement, to Nina Olson, National Taxpayer Advocate (Aug. 4, 2014). IRM 5.19.4.5.3.2, *Filing Criteria* (Jan. 1, 2015) provides that a NFTL filing threshold is $10,000, not $25,000.

Taxpayer Advocate has recommended, and the IRS has accepted, the following four treatment groups for the lien filing pilots, plus a control group:

- Treatment Group 1 will provide for the IRS to file NFTLs on a group of taxpayers with cases in the queue with unpaid liabilities between $10,000 and $25,000. TAS has requested that Collection ensure these taxpayers have been advised by someone in ACS that the NFTL will be filed and the pre-lien determination considerations in IRM 5.12.2.3 be used prior to the filing of a lien.
- Treatment Group 2 will receive a reminder notice that the taxes are still owed and that the taxpayers need to contact the IRS to resolve the delinquencies.
- Treatment Group 3 will receive a new notice that also provides more information about payment alternatives that may be available to the taxpayers.
- Treatment Group 4 will receive monthly reminder notices throughout the pilot period.
- The control group will follow the current process without any new treatment.

Using the treatment groups suggested by the National Taxpayer Advocate will result in measuring the impact of various types and frequency of contact with taxpayers instead of an automatic lien filing and would provide a basis for future NFTL filing criteria.

CONCLUSION

The IRS's policy of filing NFTLs based on an arbitrary dollar threshold fails to take into account the taxpayers' ability to repay the liability and future compliance. The IRS needs to utilize data analysis and the results of the lien pilot program to drive its decision on whether to continue using monetary thresholds to trigger NFTLs. The IRS should redefine the use of an NFTL as a powerful collection tool based on meaningful and early contact with taxpayers, automation of financial analysis and asset verification, and the impact of NFTL filing on the taxpayer's financial viability and future compliance. By developing modern, comprehensive, and automated financial analysis and using early intervention tools, including personal contact, the IRS will improve revenue collection and future compliance, and promote taxpayer *rights to a fair and just tax system* and *to privacy*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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. The IRS should 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.
2. The IRS should increase the ten-day timeframe for filing an NFTL to enable taxpayers to reach out to the IRS and provide financial information.
3. The IRS should continue to mail monthly notices to the taxpayers while the account is in the queue, ACS, or the field.
4. In collaboration with TAS, develop criteria for conducting the lien pilot as agreed upon with the National Taxpayer Advocate and refrain from decreasing the NFTL filing monetary threshold until the results of the lien pilot can be examined and discussed.
5. Amend the IRM and related e-Guides and training materials to incorporate rules for NFTL filing determinations. The rules should specify that the following items are needed prior to filing: "meaningful contact;" analysis of the taxpayer's financial situation, including a hardship determination if needed; consideration of collection alternatives; application of the balancing test, which is to balance the need for efficient collection of the tax with legitimate concerns of the taxpayer that actions be no more intrusive than necessary; and the impact on future compliance.
6. Incorporate credit scoring and automated asset verification into financial analysis for making NFTL filing determinations in ACS, with the provision to elevate close call and complex cases to a manager.
7. For accounts moving from ACS to the queue, revise the IRM to require employees to conduct a limited financial analysis based on a Form 433-F and refrain from filing an NFTL, if the employee has determined there are no assets or reasonable expectation of the taxpayer to acquire assets in the future.
8. 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

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The IRS is generally required by Internal Revenue Code (IRC) § 7602(c) to give taxpayers reasonable advanced notice before making third party contacts (TPC) and to provide them with post-contact reports both periodically and upon request. Advance notice should allow taxpayers an opportunity to volunteer information that would, in many cases, make TPCs unnecessary, avoiding potential damage to the taxpayer's business and reputation.[2] The IRS often satisfies this requirement by including Publication 1, *Your Rights as a Taxpayer* (Pub 1), or a similarly general notice with its initial contact letter. These notices are ineffective because they do not identify the information the IRS needs, inform the taxpayer the IRS *will* make a TPC in the taxpayer's particular case, or provide the taxpayer with enough advanced notice to deliver the information before the contact.[3] TAS found that in cases where the IRS made TPCs, IRS employees did not first ask taxpayers for the specific information at issue in 22.8 percent of field exam cases and 11.1 percent of field collection cases.[4]

In addition, timely post-contact reports—*i.e.*, reports provided to taxpayers informing them of which TPCs were actually made—could help taxpayers mitigate damage caused by TPCs. However, they are also ineffective because the IRS does not provide them automatically (on a periodic basis), as required by

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 *See, e.g.*, S. Rep. No. 105-174 at 77 (1998).

3 The IRS may proceed with a TPC just ten days after sending the TPC notice or immediately after confirming its receipt. IRM 4.11.57.4.1.1.1, *Providing Notification Using Publication 1* (Dec. 20, 2011); IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 16, 2014).

4 Unless otherwise indicated, the data in this discussion are drawn from a stratified random sample of 423 field collection and 485 field examination cases closed in fiscal year (FY 2013) that TAS reviewed in 2015 (collectively, the "TPC Sample (2015)"). TAS reviewers could not determine if the IRS employee had first asked the taxpayer for this information in another 22.2 percent of the field exam cases and 14.0 percent of the field collection cases. TPC Sample (2015) (Q6). For a description of the sampling methodology and tables that show the extent to which the results can be projected to the population at a 95 percent level of confidence (*i.e.*, standard errors and confidence intervals), see the appendix. For example, although we estimate that Revenue Agents (RAs) did not ask the taxpayer for specific information before asking a third party 22.8 percent of the time, the size of our sample only allows us to be 95 percent confident that the true figure is between 10.8 and 41.7 percent for the population as a whole, as shown in the appendix.

The IRS is generally required by Internal Revenue Code § 7602(c) to give taxpayers reasonable advanced notice before making third party contacts… Advance notice should allow taxpayers an opportunity to volunteer information that would, in many cases, make third party contacts unnecessary, avoiding potential damage to the taxpayer's business and reputation.

IRC § 7602(c)(3), and taxpayers have no reason to request them unless they know the IRS has made a TPC. Moreover, TPC notices generally do not inform taxpayers of how to request a report.[5] Perhaps for these reasons, taxpayers did not request TPC reports in any of the 908 cases that TAS reviewed.[6] Even if a taxpayer requests one, the IRS does not have sufficient controls in place to ensure exceptions to the TPC reporting requirements are applied correctly or that the reports are complete. TAS found the IRS's TPC database, which it uses to generate these reports, was incomplete in 42.1 percent of field examination cases and in 48.5 percent of field collection cases.[7] Moreover, the IRS's case quality reviews do not effectively detect these discrepancies.

Addressing these problems would help minimize unnecessary damage to the taxpayer's reputation and business and further the taxpayer's *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*.[8] Thus, the IRS's current TPC procedures dilute five of the ten taxpayer rights adopted by the IRS.

ANALYSIS OF PROBLEM

When the IRS Contacts Third Parties, It Discloses Confidential Taxpayer Information Otherwise Protected Under IRC § 6103

In general, IRC § 6103 prevents IRS employees from disclosing confidential taxpayer information. If they unnecessarily disclose taxpayer information, the taxpayer may sue the IRS for damages.[9] However, IRS employees may disclose confidential return information to the extent necessary to conduct their official duties.[10] For example, IRS employees may need to disclose to a taxpayer's customers, employees, or colleagues that he or she is under investigation by the IRS to obtain information in connection with an examination or investigation. Some customers may decide to use other suppliers in light of the implication that the IRS suspects the taxpayer is a tax cheat or has unpaid tax liabilities. TAS's study found the IRS made TPCs in 68.1 percent of its field collection cases and 8.5 percent of its field examination cases.[11] Although in some instances damage to the taxpayer's reputation and business may be unavoidable, IRC § 7602(c) provides some procedural protection.

5 IRS training materials for TPC coordinators indicate that if a taxpayer requests a list from an IRS employee, the employee should forward the request to the TPC coordinator. IRS response to TAS information request (June 29, 2015).

6 TAS Sample (2015) (Q1 and Q11). Specifically, 284 of the 908 cases TAS reviewed had a non-exempt TPC and no one requested a TPC report.

7 TAS Sample (2015) (Q9). Please see the appendix for confidence intervals.

8 IRS Pub 1, *Your Rights as a Taxpayer* (Dec. 2014).

9 IRC § 7431; IRM 11.3.1.6.4, *Civil Liberty Under IRC § 7431* (May 24, 2005).

10 *See, e.g.*, IRC § 6103(k)(6); Treas. Reg. § 301.6103(k)(6)-1; IRM 4.2.5.3, *Investigative Disclosures* (July 29, 2011).

11 TPC Sample (2015) (Q1). Please see the appendix for confidence intervals.

IRC § 7602(c) Requires the IRS to Notify Taxpayers Before Making TPCs and to Provide Them With Reports of TPCs

Enacted as part of the Internal Revenue Restructuring and Reform Act of 1998 (RRA 98), IRC § 7602(c)(1) provides that:

> An officer or employee of the Internal Revenue Service may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer without providing *reasonable notice in advance* to the taxpayer that contacts with persons other than the taxpayer may be made. (Emphasis added).[12]

In addition to the advance TPC notice requirement, IRC § 7602(c)(2) requires the IRS to provide the taxpayer with a record of TPCs both "periodically" and upon request. If taxpayers know which third parties the IRS contacted, they may be able to mitigate the resulting damage.

The Advanced TPC Notice Requirement Is Supposed to Give Taxpayers an Opportunity to Volunteer Information

In describing the reasons for IRC § 7602(c), the Senate Committee on Finance report explains:

> [T]axpayers should be notified before the IRS contacts third parties regarding examination or collection activities with respect to the taxpayer. Such contacts may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community. Accordingly, the Committee believes that taxpayers should have the *opportunity to resolve issues and volunteer information before the IRS contacts third parties*.[13]

The preamble to the Treasury Regulations reiterates that the TPC procedures:

> *[E]nable a taxpayer to come forward with information required* by the IRS before third parties are contacted. The taxpayer's business and reputational interests therefore can be addressed without impeding the IRS' ability to make those third-party contacts that are necessary…[14]

Similarly, the current Internal Revenue Manual (IRM) acknowledges:

> [T]he intent behind this statute is to prevent the Service from disclosing to third parties that the taxpayer is the subject of a Service action without first providing reasonable notice to the

12 Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3417, 112 Stat. 685, 757 (1998). The language of IRC § 7602(c)(1) differs from the bill that passed in the Senate, which would have required the IRS to identify specific third parties. H.R. 2676, § 3417, 105th Cong. 2d Sess. (May 7, 1998) (requiring the IRS to provide the taxpayer with "reasonable notice" of "such contact"). *See also*, Third Party Contacts, NPRM, 66 Fed. Reg. 77 (Jan 2, 2001) ("As originally drafted by the Senate Finance Committee, the third-party contact rule would have prohibited most IRS contacts with third parties prior to taxpayer notification of the specific contact to be made... The requirement for specific pre-contact notice was modified by the Conference Committee to require only a generalized notice of IRS intent to contact third parties..."). If this change was based on a concern that if the taxpayer knew who the IRS would contact he or she might try to influence a third party's testimony, it would still be reasonable to expect the IRS to give the taxpayer advanced notice of the specific information it would seek from third parties if not provided by the taxpayer.

13 S. Rep. No. 105-174 at 77 (1998) (emphasis added). The Conference Report explains the IRS will provide "reasonable notice in advance to the taxpayer that the IRS may contact persons other than the taxpayer," and contemplates that it will "be provided as part of an existing IRS notice." Conf. Rept. 105-599 at 277 (1998). Thus, the IRS could include a specific TPC notice in an existing notice or letter, such as an information document request (IDR) or in correspondence confirming its receipt or non-receipt of the taxpayer's response to an IDR. The IRS could revert to its practice of using IRS Letter 3164-G (DO), *(Exam-3) Third Party Contact Letter*, for this purpose.

14 T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002) (emphasis added). *See also* Chief Counsel Advice (CCA) 200109047 (2001) ("[T]he congressional intent behind these requirements is to provide taxpayers with the opportunity to come forward with information before third parties are contacted and the means to address any reputational concerns arising from such contacts...").

> taxpayer and allowing the taxpayer an opportunity to provide the information and resolve the matter.[15]

When the TPC is to verify information already provided by the taxpayer, a reasonable notice can be less specific because the taxpayer is unlikely to avoid it by providing the verification.[16] When the TPC is to obtain information, however, reasonable advanced notice may require the IRS to identify the specific information it needs so the taxpayer can avoid the contact by either providing the information or resolving the matter. Indeed, practitioners, including representatives of the State Bar of California Tax Section, have complained that the IRS's current TPC notice process does not give taxpayers a realistic opportunity to provide the information (or to resolve the matter) and avoid TPCs.[17]

TPC Notices Can Be So Vague That the Taxpayer Has No Opportunity to Provide the Information

The IRM explains that "*[G]enerally*, contacts with third parties are made when the examiner is unable to obtain the information from the taxpayer or when it is necessary for the examiner to verify the information provided by the taxpayer."[18] However, it does not actually require the employee to first request the information from the taxpayer or even disclose what information the examiner plans to seek from third parties.

The IRS uses Pub 1 and various other documents to satisfy the TPC notice requirement.[19] They generally include language such as the following:

> Generally, the IRS will deal directly with you or your duly authorized representative. However, we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received. If we do contact other persons, such as a neighbor, bank, employer, or employees, we will generally need to tell them limited information, such as your name. The law prohibits us from disclosing any more information than is necessary to obtain or verify the information we are seeking. Our need to contact other persons may continue as long as there is activity in your case. If we do contact other persons, you have a right to request a list of those contacted.[20]

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15 IRM 4.11.57.2(3) (Jan. 17, 2014) (emphasis added). *See also* IRM 4.10.3.2.1.4, *Third Party Interviews* (Mar. 1, 2003).

16 *See, e.g.*, Treas. Reg. § 301.6103(k)(6)-1(d) (Ex. 1) ("In contacting the suppliers, the revenue agent discloses the taxpayer's name, the dates of purchase, and the type of merchandise at issue. These disclosures are permissible under section 6103(k)(6) because, under the facts and circumstances known to the revenue agent at the time of the disclosures, the disclosures were necessary to obtain information (corroboration of invoices) not otherwise reasonably available because suppliers would be the only source available for corroboration of this information."). An IRS CCA has approved the practice of sending general notices to verify wage information—a context in which less specific notice may, in fact, be reasonable. CCA 200814008 (Apr. 4, 2008).

17 *See, e.g.*, Kevan P. McLaughlin, State Bar of California Tax Section, *Balancing Privacy and Efficiency Under Section 7602: What Is "Reasonable Notice" and Changing IRS Procedures Related to Third Party Contacts* (2012); Systemic Advocacy Management System (SAMS), Submission 26446 (Feb. 5, 2013).

18 IRM 4.11.57.4(1) (Dec. 20, 2011) (emphasis added). *See also* IRM 4.32.2.7.3.2(3) (2012) ("Examiners should attempt to obtain the information in writing from the promoter before contacting any third parties."); IRM 25.27.1.3, *Notification Requirements* (Jan. 16, 2014) ("It is the Service's practice to obtain information relating to a liability or collectability determination directly from the taxpayer whenever possible."); IRM 4.10.3.2.1.4(2) (Mar. 1, 2003) ("Information will be collected, to the greatest extent practicable, directly from the taxpayer to whom it relates... Information about taxpayers collected from third parties will be verified to the extent practicable with the taxpayer before action is taken.").

19 *See, e.g.*, IRM 25.27.1.3.1(1) (Jan. 16, 2014). For example, Letters 3164, 3230, 3232, 3234, 3236, 3238, 3345, 3404, 4464, and Notice 1219 all contain TPC language.

20 IRS Pub 1, *Your Rights as a Taxpayer*.

This language is vague. It does not even reveal whether the IRS plans to make a TPC in the taxpayer's particular case. Moreover, the IRS generally delivers the TPC notice with the initial contact letter—potentially before the IRS has requested any information from the taxpayer.[21] Finally, this language fails to disclose that the IRS is required to provide the taxpayer with periodic reports of the TPCs it makes. Instead, the IRS ignores the law and places the burden on the taxpayer to request such reports (as discussed below).

The IRS No Longer Provides a Second, More Specific TPC Notice

The IRS used to provide more specific TPC notices. In testimony before the Senate Finance Committee on February 2, 2000, Commissioner Rossotti explained that:

> When we first implemented this provision [TPC notices], we attempted a "one size fits all" approach by sending a broadly written notice to virtually every taxpayer in our administrative stream… The reaction was immediate, strong, and negative. We were told that the generic nature of the notice did not provide its recipients with any indication of why we would contact third parties to talk about their tax situations or what information we would seek.[22]

Accordingly, under IRS procedures in effect between 2000 and 2005, the IRS issued a general TPC notice followed by a more detailed one.[23] The second notice was more likely to alert the taxpayer that the IRS was actually planning to make TPCs unless it received additional information from the taxpayer. These notices included a specific IRS employee's contact information and sometimes even identified the specific information that the IRS needed or needed to verify and why. For example, Letter 3164-G (DO), *(Exam-3) Third Party Contact Letter*, specifies the information the IRS needs and the date it was requested from the taxpayer. Similarly, Letter 3164-F (DO), *(Exam-2) Third Party Contact Letter*, identifies the specific information the IRS needs to verify.[24]

21 IRM 4.10.2.7.4.2, *Contacting the Taxpayer by Letter* (Apr. 2, 2010) (requiring Pub 1 to be included with the initial contact letter).

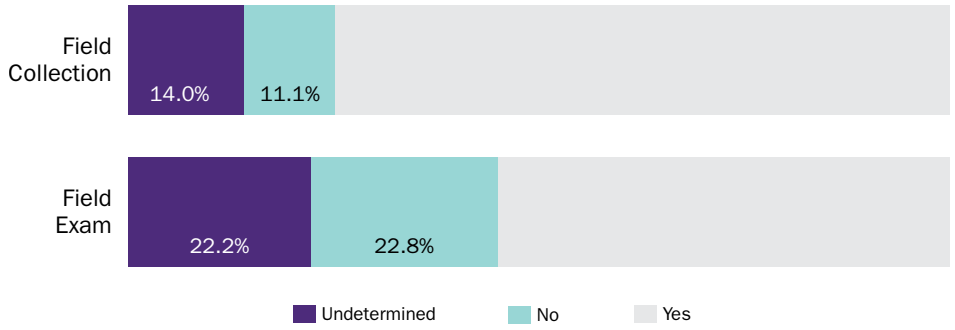
22 *Hearing Before the S. Finance Comm. on Status of IRS Reform*, 106th Cong. 2nd Sess. 46 (2000) (testimony of IRS Commissioner Rossotti).

23 The IRS previously sent Notice 1219, which included language similar to Pub 1, and then followed up with one of the more specific versions of Letter 3164. *See, e.g.*, IRM 4.10.1.6.12.2.1(5), *Notification Procedures* (May 14, 1999) ("CAUTION: Providing the taxpayer with Notice 1219 alone does not constitute adequate notification of third party contacts. It must be attached to another letter that contains the required information found in Letter 3164: date, taxpayer's name, address and TIN, employee's name, telephone number, identification (badge) number and officer hours, tax form, type of tax and tax period(s)."). The 1999 version of IRM 4.10.1.6.12.2.1, which described this two-notice process, remains a part of the current IRM, but it conflicts with more current guidance, which states that a second more-specific TPC notice is not required. *See, e.g.*, IRM 4.11.57.4.1.1, *Procedures for Providing Advance General Notice That Third Parties May Be Contacted* (Dec. 20, 2011); IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 1, 2014); IRM 4.8.8.18.1(2) (July 1, 2011). *Accord*, T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002) (describing "general pre-contact notice followed by post-contact identification…").

24 Letter 3404C, *AUR Third Party Contact*, even identifies the third parties to be contacted. By contrast, Letter 3164-N, *Third Party Contact to Preparers*, and Letter 3164-P, *Third Party Notification for IRC 6700/6701 Investigations*, provide more generic statements such as the one quoted above.

However, the IRS has reverted to its prior practice of providing a single generic notice. According to the current IRM, Letters 3164-G and 3164-F "are no longer applicable because notice is given via Pub 1."[25] This guidance may suggest that those who take the trouble to identify and request the specific information from the taxpayer before making a TPC to obtain it are going beyond what is required. TAS found that in 22.8 percent of field exam cases and 11.1 percent of field collection cases IRS employees did not ask taxpayers for such specific information before making TPCs to obtain it.

FIGURE 1.12.1[26]



The IRS Does Not Provide TPC Notice Far Enough in Advance to Allow the Taxpayer to Provide the Information

Even if the IRS were to give taxpayers meaningful advance TPC notice (*e.g.*, by using Letter 3164-G or something similar), IRS employees can make TPCs just ten business days after sending it or immediately after they deliver it by hand or otherwise confirm its receipt.[27] TAS's review found that IRS employees did not even wait this long in 5.3 percent of the field collection cases and in 2.3 percent of the field exam cases.[28] Similarly, an IRS review of 39 field examination cases closed without agreement in

25 IRM 4.11.57.4.1.1, *Procedures for Providing Advance General Notice That Third Parties May Be Contacted* (Dec. 20, 2011). *See also*, IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 1, 2014) ("If the appropriate Letter 3164 **or** Publication 1 (Pub 1), *Your Rights as a Taxpayer*, version dated 09/2012 has been sent and the requisite waiting period has lapsed, the employee may seek additional information." (Emphasis added)); IRM 4.8.8.18.1(2) (July 1, 2011) (explaining, "[P]reviously, the advance general notice of potential third-party contact was usually accomplished by issuance of one of several versions of Letter 3164, *Third Party Notice*. In May 2005, Pub 1, *Your Rights as a Taxpayer*, was revised to include the advance general notice of potential third-party contact that is required by IRC § 7602. This revision is consistent with the amendment of IRC § 7602, as the Conference Committee Report (H.R. Conf. Rep. 105-599) for that section specifies, '[I]t is intended that in general this notice will be provided as part of an existing IRS notice provided to taxpayers.'"). *Accord* IRM 5.1.1.10.1, *TPC Advance Notification Procedures* (May 15, 2014) ("Letter(s) 3164 B or C (DO) are not required prior to making a third party contact as long as the revenue officer can verify through ICS that the taxpayer has received a Pub 1 (Rev. 05/2005) and/or Notice CP-504 or Notice CP-518.").

26 TPC Sample (2015) (Q6). Although we estimate that RAs and ROs did not ask the taxpayer for specific information before asking a third party 22.8 and 11.1 percent of the time (respectively), the size of our sample only allows us to be 95 percent confident that the true figure is within the range of 10.8 to 41.7 percent for RAs and 7.8 to 15.6 percent for ROs, as shown in the appendix.

27 IRM 4.11.57.4.1.1.1, *Providing Notification Using Publication 1* (Dec. 20, 2011); IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 16, 2014).

28 TPC Sample (2015) (Q5).

fiscal year (FY) 2014 found that in 13 percent, the examiner did not provide the taxpayer with appropriate advanced notice of the TPC.[29]

In addition, practitioners have complained that a TPC notice delivered immediately before the contact leaves the taxpayer with no opportunity to provide information to the IRS.[30] Even ten days is not likely to give the taxpayer enough time to obtain information (potentially from third parties) and deliver it to the IRS, assuming the notice is specific enough that the taxpayer knows what information the IRS needs.

The IRS Provides a Specific and Timely Notice When It Issues a Third-Party Summons

In contrast to other TPCs, when the IRS issues a third-party summons, it is generally required to give the taxpayer a copy of the summons that identifies a specific third party, the information being summoned, and a discussion of the taxpayer's right to bring an action to quash the summons.[31] Such specific information is necessary to empower the taxpayer to provide the information or initiate proceedings to quash the summons before it is executed.

The IRS generally must provide the taxpayer with a copy of the summons within three days of issuing it and no later than 23 days before the third party is required to respond.[32] A taxpayer would probably need at least as much time to gather information (potentially from a third party) and transmit it to the IRS, as contemplated by the TPC notice requirement. Thus, unlike the TPC notice, the third-party summons notice identifies the information the IRS needs, who the IRS believes may have it, and is delivered to the taxpayer far enough in advance that the taxpayer has an opportunity to obtain and deliver the information to the IRS (making summons enforcement unnecessary) or take action to quash it.

The IRS could potentially reduce internal paperwork while increasing the transparency of its third party contacts by providing the taxpayer with a copy of any written request for information from (or an interview with) a third party, instead of sending Form 12175 to the third party contact coordinator.

Increased Transparency Could Reduce the Resources Needed to Track and Report TPCs

To comply with the requirement to provide taxpayers with a record of TPCs, IRS employees record them on Form 12175 (in addition to their normal case activity record) and send it to a TPC coordinator, so that the coordinator can track and report TPCs to the taxpayer upon request.[33] This paperwork is not required with respect to TPCs already provided to the taxpayer.[34] For example, if the IRS gives the taxpayer a copy of a third-party summons, the taxpayer already has a record of the TPC. For this reason, IRS employees do not need to track third-party summons, provide them to the TPC coordinator, or include them in TPC reports provided to the taxpayer.[35] Thus, the IRS could potentially reduce internal paper-

29 SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 4-5 (Oct. 30, 2015). This was a review of cases involving non-filers, return preparers, or information reports that were closed unagreed in FY 2014 with TPCs that were documented by examiners on contact sheets. *Id*. Unlike the cases TAS reviewed, SB/SE's cases were not selected using a random sampling methodology. *Id*. Examiners are not required to ask the taxpayer for the information before asking a third party, and SB/SE's review did not consider whether examiners had done so.

30 *See, e.g.*, Kevan P. McLaughlin, State Bar of California Tax Section, *Balancing Privacy and Efficiency Under Section 7602: What Is "Reasonable Notice" and Changing IRS Procedures Related to Third Party Contacts* (2012).

31 IRC § 7609(a).

32 *Id.*

33 IRM 25.27.1.4, *Recording and Reporting TPCs* (Jan. 16, 2014).

34 Treas. Reg. § 301.7602–2(e)(3).

35 Treas. Reg. § 301.7602-2(e)(4) (Example 4); IRM 4.11.57.5.1, *Documentation of Contact Not Required* (Jan. 17, 2014).

work while increasing the transparency of its TPCs by providing the taxpayer with a copy of any written request for information from (or an interview with) a third party, instead of sending Form 12175 to the TPC coordinator.

The IRS Is Violating the Law by Failing to Provide Taxpayers With Periodic Reports

The IRS only provides post-contact reports to taxpayers upon request. It does not provide them to taxpayers "periodically," as required by IRC § 7602(c)(3).[36] The IRS's failure to provide "periodic" TPC reports violates IRC § 7602(c)(3). Although the IRS proposed regulations that would have implemented periodic reporting, the final regulations omit these provisions, explaining that the IRS and Treasury "determined that the issuance of periodic reports may result in harm to third parties and, accordingly, has determined that periodic reports should not be issued."[37] It does not indicate hat TPC reports are optional under the law

The IRS may take the position it is not violating the law because the regulation implicitly presents a re-interpretation of the statutory requirement, but the language in the preamble seems more properly described as an explanation for why the IRS has decided to violate the law. A regulatory preamble does not carry the same force as a regulation. Moreover, even a regulation that had been subject to notice and comment (and the preamble to the final regulations was not) could not overturn such a clear statutory mandate under *Chevron* step-one.[38]

In addition, the reason given by the preamble (*i.e.*, "harm to third parties") does not make sense. The regulations already protect third parties by providing that the IRS will withhold the identity of those who may be subject to reprisal.[39] It would be illogical to withhold TPC reports from taxpayers to protect third parties whose identities would not be disclosed on those reports.[40] Further, if the government were concerned about harm to the third parties, it is unclear why it would nonetheless provide *ad hoc* reports upon request that would reveal their identities. Although the IRS may now speculate that it was concerned that third parties who do not express any fear of reprisal could, in fact, be harmed if periodic reports were delivered, it did not express this concern in the preamble to the regulations (and there does not appear to be any evidence to support it) or present any other evidence for its disregard of a statutory taxpayer protection.

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36 IRM 4.10.1.6.12.3, *Providing Taxpayers With Notice of Third Party Contacts* (May 14, 1999) states that the IRS will provide the taxpayer with a list of TPCs once per year, but it became obsolete once the IRS issued Treasury Regulations in 2002. T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002). *See also* IRM 4.11.57.4.6, *Provide a List to the Taxpayer* (Dec. 20, 2011). A seemingly obsolete IRS training document directs employees to inform third parties their name will appear on a list of contacts that will be sent to the taxpayer "once a year" unless the third party indicates that including his or her name may result in reprisal. IRS response to TAS information request (June 29, 2015). TAS has also confirmed with TPC coordinators that they do not send periodic reports.

37 *Compare Third Party Contacts*, NPRM, 66 Fed. Reg. 77-84 (Jan 2, 2001) (proposed regulations), *with* T.D. 9028, 67 Fed. Reg. 77,419, 77,420-25 (Dec. 18, 2002) (final regulations). Contemporaneous news reports of an employee in Wakefield, Massachusetts who killed seven co-workers after learning about a pending wage levy could have colored the IRS's thinking about the periodic reporting requirement. *See* Carey Goldberg, *7 Die in Rampage at Company; Co-Worker of Victims Arrested*, N.Y. Times (Dec. 27, 2000), *available at* http://www.nytimes.com/2000/12/27/us/7-die-in-rampage-at-company-co-worker-of-victims-arrested.html. However, this particular shooting occurred before the IRS issued the proposed regulations that would have provided periodic reports. Moreover, the IRS could not have concealed a wage levy from the shooter in any event.

38 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). A court only gives deference to agency regulations under *Chevron* step-two, if it first determines the statute is ambiguous under *Chevron* step-one. *Id*.

39 Treas. Reg. § 301.7602-2(f)(3).

40 However, SB/SE found that field examiners did not document consideration of reprisal in any of the TPC cases it reviewed. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 1 (Oct. 30, 2015). SB/SE suggested this may result, in part, because 70 percent of the TPCs in the cases it reviewed were conducted using Letter 1995, which was last revised in 1985, before IRC § 7602(c) was enacted, and does not include any language concerning reprisal. *Id*. at 6.

Further, there is a difference between requiring the IRS to provide periodic TPC reports and merely making them available upon request. Many taxpayers who would want to know who the IRS contacted will not know that any contacts were made. Providing TPC reports only upon request also burdens taxpayers to take action where otherwise they would be informed of TPCs automatically. Inasmuch as Congress enacted the periodic reporting requirement to empower taxpayers to repair their reputations, and to ensure that taxpayers know what the IRS is doing, the IRS's nullification of the periodic reporting requirement frustrates that purpose.

Finally, to the extent the IRS gives the impression it is ignoring the law, it may encourage taxpayers to ignore tax laws. It will also seem hypocritical when the IRS enforces them.

The IRS Should Do More to Empower Taxpayers to Receive TPC Reports

Because the IRS does not send periodic TPC reports, it is even more important for it to empower taxpayers to request TPC reports so that they can mitigate damage from the TPCs. However, the IRS no longer informs taxpayers when it makes a TPC, nor does it explain how to request a list of TPCs.[41] Perhaps for these reasons, taxpayers did not request TPC reports in any of the 908 cases that TAS reviewed.[42] Thus, the IRS should do more to alert taxpayers when TPCs have been made and explain how they can request TPC reports.

There Are No Effective Remedies for Taxpayers Harmed by the IRS's Violation of the TPC Notice and Reporting Requirements

If IRS employees violate the TPC notice requirements or erroneously omit TPCs from the list provided to the taxpayer, taxpayers have little recourse. In theory, a taxpayer may seek to quash a third-party summons on the basis that the IRS failed to follow IRC § 7602(c), but those who receive Pub 1 before the IRS issues a summons are unlikely to prevail.[43] Moreover, if a third party provides information voluntarily, the IRS would have no reason to issue a summons. In limited circumstances, a taxpayer may also seek to recover actual civil damages resulting from an IRS employee's failure to follow procedures in connection with a third party contact.[44] However, Chief Counsel Advice (CCA) suggests the IRS has never been sued on this basis because it is difficult for taxpayers to show actual damages.[45] Without judicial remedies for the violations of the important taxpayer protections afforded by IRC § 7602(c), taxpayers depend on the IRS's internal controls to ensure employees comply with the law.

41 For example, neither Pub 1 nor Letter 3164-N, *Third Party Contact to Preparers*, explain who a taxpayer should call or write to in making the request and whether any particular form is required.

42 TPC Sample (2015) (Q1 and Q11). Specifically, 284 of the 908 cases TAS reviewed had a non-exempt TPC and no one requested a TPC report.

43 *See, e.g.*, *U.S. v. Jillson*, 84 A.F.T.R.2d 99–7115 (S.D.Fla.,1999) (unreported) (quashing summons issued before TPC notice); *Gangi v. U.S.*, 107 A.F.T.R.2d 2011-1542 (D.N.J. 2011) (unreported), *aff'd* 453 Fed. App'x. 255 (3rd Cir. 2011) (same). *But see, e.g.*, *Thompson v. U.S.*, 102 A.F.T.R.2d 2008-6130 (S.D. Tex. 2008) (unreported) (refusing to quash a summons issued after TPC notice included in Pub 1); *Gangi v. U.S.*, 2 F.Supp.3d 12 (D. Mass. 2014) (same).

44 *See, e.g.*, IRC §§ 7433 (damages for unauthorized collection actions by the IRS); 7433A (damages for unauthorized collection actions by contractors). Taxpayers can also sue for damages if an IRS employee unnecessarily discloses taxpayer information protected by IRC § 6103. IRC § 7431; IRM 11.3.1.6.4, *Civil Liberty Under IRC § 7431* (May 24, 2005).

45 *See, e.g.*, CCA 2013071915074952 (2013) ("There is no independent cause of action for violating third-party contact rules. As far as we are aware, the IRS has never been sued for violating the third-party contact rules, though taxpayers have occasionally attempted to assert these types of violations as a defense to summons enforcement or collection actions. In theory, a violation of section 7602(c) might support a suit by a taxpayer against the IRS under section 7433. However, section 7433 only allows a taxpayer to recover actual, direct economic damages and court costs. It is unclear what actual, direct economic damage a taxpayer would suffer as a result of a violation of section 7602(c).").

Without Sufficient Oversight, Employees Could Fail to Record TPCs on the Database or Apply the "Reprisal" Exception Excessively

Low-Graded IRS Employees Are Authorized to Make Reprisal Determinations Without Oversight

There are several exceptions to the TPC notice and reporting requirements, including situations where an IRS employee has "good cause to believe" that disclosure of the contact "may cause any person to harm any other person in any way" (*i.e.*, a risk of reprisal).[46] The IRS has delegated the authority to make such determinations to low-graded (GS-4 and GS-5) employees.[47] Employees are not required to investigate a third party's reprisal claim, but they should be required to document some valid basis for the determination (*e.g.*, that a third party expressed a fear of reprisal rather than simply a preference not to be named).[48] One commentator argued that because "good cause" is a low standard that is determined solely by the IRS employee making the contact, it would make them a "nullity."[49] The commentator recommended that reprisal determinations be documented and subject to supervisory review, but this comment was rejected without explanation. Nonetheless, it would make sense for a supervisor to ensure the employee considered reprisal and included some valid reason for any reprisal determination in the file.

Post-Examination Quality Reviews May Not Reliably Identify Third Party Contact Problems

After the IRS closes an examination, its technical services function may review whether the examiner documented any applicable exceptions to the reporting requirements.[50] However, the reviewer would not necessarily look for anything more than something like: "No third party reporting is required because there is a risk of reprisal" (or some other conclusory justification).[51] Thus, an employee is not necessarily required to document the "good cause" underlying his or her reprisal determination. Although TAS's sample included only seven reprisal determinations (six in collection and one in exam), employees did not document the reasons for those determinations in any the cases TAS reviewed.[52]

In theory, Field Exam National Quality Review System Attribute 617, which covers whether the taxpayer was "advised of all rights and kept informed throughout the examination process," could cover failures to provide advanced notice of third party contacts.[53] Because the IRS does not associate a "reason code" with third party contact rule violations, however, the only way to determine if a failure for "other" reasons

46 Treas. Reg. § 301.7602-2(f)(3); IRM 4.11.57.4.2.3, *Reprisal* (Jan. 17, 2014); IRM 25.27.1.3, *Notification Requirements* (Jan. 16, 2014).

47 Authority to make the reprisal determination is delegated to Revenue Agents, Examination Aides, Tax Auditors, Revenue Officers, Tax Compliance Officers, Bankruptcy Specialists, GS-4 Tax Examiners, GS-5 Revenue Officer Aides, GS-5 Correspondence Examination Technicians, and GS-5 ACS Collection Representatives, among others. *See* IRM 1.2.52.13, *Delegation Order 25-12 (Rev. 1)* (May 22, 2009).

48 Treas. Reg. § 301.7602-2(f)(3)(i) ("A statement by the person contacted that harm may occur against any person is sufficient to constitute good cause for the IRS employee to believe that reprisal may occur. The IRS employee is not required to further question the contacted person about reprisal or otherwise make further inquiries regarding the statement"); Treas. Reg. § 301.7602-2(f)(3)(ii) (Ex. 1) (explaining a "contact is not excepted from the statute merely because the... [third party] asks that his name be left off the list of contacts.").

49 T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002).

50 IRM 4.8.8.18.3(3) (Dec. 6, 2013) ("The reviewer will review Form 9984 to ensure that the examiner documented whether the exceptions to the notice requirements of IRC 7602(c) applied...").

51 Although not required by the current IRM, seemingly-obsolete training for TPC coordinators states that "[E]mployees *should* document the case file with the facts surrounding the decision and complete a Form 12175 as outlined above to document the reprisal determination." IRS response to TAS information request (June 29, 2015) (emphasis added).

52 TPC Sample (2015) (Q8).

53 SB/SE, *Field Compliance Embedded Quality, Field Examination Attribute Job Aid*, Doc. 13128 (Dec. 2014); IRM Exhibit 4.8.3-1, *Quality Attributes* (Mar. 21, 2013).

is due to third party contact problems is to review the narrative provided by the reviewer.[54] When the IRS searched the narratives for FYs 2012-2014 cases closed by Small Business/Self-Employed (SB/SE) Division Revenue Agents (RAs) and Tax Compliance Officers (TCOs) that failed Attribute 617 for "other" reasons, it found no mention of third party contact violations. This may suggest that reviewers were not looking for such violations, perhaps because there was no reason code for them or because they were difficult to detect.[55]

One reason TPC reporting violations are difficult to detect is because employees are not always required to include the TPC's identity on Form 12175 or the TPC database. For example, the contact's name is omitted from the form when there is a risk of reprisal. To identify an incorrectly excluded contact, a reviewer would have to compare the TPCs in the paper case file (if any) with the number and date of those reflected in the TPC database. TAS's review found that in 42.1 percent of the field exam cases non-exempt TPCs were missing from the TPC database.[56] Similarly, in a limited one-time review of certain field exam cases with TPCs, SB/SE found that in 36 percent, examiners did not properly document TPCs reflected in case histories on Form 12175.[57] Even where Form 12175 was used, only about 71 percent of the case histories included information about the contact.[58] Thus, it appears that the IRS's regular field exam quality reviews do not effectively capture such omissions.

Post-Collection Quality Reviews May Not Reliably Identify Third Party Contact Problems

The IRS also reviews closed collection cases to identify errors on specific quality attributes. Field collection quality Attribute 607 addresses whether "the Third Party Contact Database was [not] updated when identifiable third party contact was made."[59] The IRS's Integrated Collection System (ICS) functions as a Revenue Officer's (RO) case activity record. It automatically updates the TPC database whenever a RO records an activity that involves a TPC (*e.g.*, a levy). The RO records such activities by selecting them from a "pick list." Except for cases involving Trust Fund Recovery Penalties or manual levies where the RO might instead use Form 12175, it is difficult for an RO to avoid updating the TPC database if he or she selects the appropriate pick list item.[60] Nonetheless, in nearly half (48.5 percent) of field collection cases TAS found non-exempt TPCs that were omitted from the TPC database.[61]

54 SB/SE RAs scored between 82.4 and 90.9 percent on attribute 617 over the last three years (FY 2012-2014) and SB/SE TCOs scored between 94.0 and 95.3 over the same period. IRS response to TAS information request (May 18, 2015).

55 IRS response to TAS information request (May 18, 2015). When it conducted the same review for RAs in Specialty Excise or Employment Tax, SB/SE found a few references to noncompliance with the third party contact rules. *Id*. These comments were associated with attribute 409 (appropriate procedural actions) or 609 (confidentiality), however. *Id*.

56 TPC Sample (2015) (Q9). As noted below, TAS's review also identified nonexempt TPCs that were omitted from the TPC database in 48.5 percent of the field collection cases. *Id*. These omissions often (94.5 percent in exam cases and 34.5 percent in collection cases) occurred because the RA or RO did not send Form 12175 to the TPC coordinator, or in 57.2 percent of the collection cases, because the RO did not use the proper pick list item, as discussed below. *Id*. (Q10).

57 SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 5-6 (Oct. 30, 2015).

58 *Id.*

59 SB/SE, *Field Compliance Embedded Quality Field Collection (FC) Job Aid*, Doc. 12359, 27-28 (Dec. 2014) (Reason Code 5).

60 IRM 5.1.1.10.2, *TPC Reporting and Recording Procedures* (May 15, 2015) ("ICS systemically generates TPC data and updates the TPC Command Code database... Usually, the Form 12175 will not need to be completed by Collection personnel. Exceptions, however, are manually prepared levies, Trust Fund Recovery Penalty Investigations, Jeopardy and Other Investigations, templates or documents created in Word."); ICS Users Guide at 10-31 and 29-11 to 29-15 (Jan. 2015).

61 TAS Sample (2015) (Q9). TAS reviewers concluded that 34.5 percent of these omissions resulted because the RO did not send Form 12175 to the TPC coordinator and 57.2 percent occurred because the RO did not select the proper entry from the ICS pick list. *Id*. (Q10).

Further, ROs failed to document a reason for their reprisal determinations in each of the six cases in TAS's sample where ROs made them.[62] Thus, Attribute 607 may not reliably identify all violations of the third party contact rules.

The IRS Could Do More to Ensure Post-Contact Reports Are Accurate

To improve the accuracy of post-contact reports, the IRS could review the work completed by TPC coordinators.[63] Employees who send Form 12175 to the TPC coordinator could confirm its receipt, as they do when they transmit returns.[64] The IRS could also reconcile TPCs reflected in case histories with those found in the TPC database to ensure employees record TPCs on Form 12175 (when necessary) and the TPC coordinator enters them into the database.[65] As noted above, such controls will be less burdensome if the IRS increases the transparency of TPCs, for example, by sending the taxpayer a copy of any written request for information from a third party within three days of the contact, as it does in connection with third-party summonses.[66]

CONCLUSION

Improving the TPC notice and reporting procedures would be consistent with the recently-adopted Taxpayer Bill of Rights. The taxpayer's *right to be informed*, as described in Pub 1, includes the right to "be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes." Under current procedures, however, the IRS issues vague or non-specific TPC notices and potentially incomplete TPC reports that do not allow taxpayers to be informed about what information the IRS has decided it needs from third parties, whether it has actually contacted third parties, and how to obtain a list of the TPCs.

Pub 1 also explains that the taxpayer's *right to privacy* includes the right to "expect that any IRS inquiry… will comply with the law and be no more intrusive than necessary." With the possible exception of certain

62 TAS Sample (2015) (Q7 and Q8).

63 Except for personal performance appraisals, the IRS does not regularly evaluate the quality of the work completed by TPC coordinators, nor does it regularly reconcile TPCs reflected in case histories with those found in the TPC database to ensure employees record TPCs on Form 12175 (when necessary) and the TPC coordinator enters them into the database. IRS response to TAS fact check (Nov. 10, 2015).

64 According to a limited review of certain field exam cases by SB/SE, in 36 percent the examiner did not properly record the contact on Forms 12175. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 5 (Oct. 30, 2015). Even when examiners filled out Form 12175 it only reached the TPC 92 percent of the time. *Id*. at 6. When an IRS employee ships one or more returns, he or she must include Form 3210, *Document Transmittal*, to provide a method for tracking their receipt. Form 3210 can be manually prepared or computer generated by ERCS. It must identify the taxpayer's name, tax period(s), to whom it is being sent, the originator, and the date sent. The sender must sign and date the form and keep a portion. Upon receipt of the return(s), the recipient must verify the contents, sign Form 3210, and return the acknowledgment portion to the sender. *See*, *e.g.*, IRM 1.4.40.4.2.6, *Shipment of Returns* (May 19, 2010).

65 IRS field exam embedded quality Attribute 617 addresses third party contacts. *See* IRM 4.11.57.1, *References – Third Party Contacts* (Jan. 17, 2014). However, it only seems to address whether the IRS informed the taxpayer that a TPC could occur (*e.g.*, by sending Pub 1). *See* IRM Exhibit 4.8.3-1, *Quality Attributes* (Mar. 21, 2013) ("This Attribute [617] measures if the taxpayer/representative was advised of all rights and kept informed throughout the examination process."). By contrast, SB/SE's Field Collection quality measures are more specific, addressing whether "[T]he Third Party Contact Database was not updated when an identifiable third party contact was made." SB/SE, *Field Compliance Embedded Quality Field Collection (FC) Job Aid*, Doc. 12359, 27-28 (Dec. 2014) (Reason Code 5). As noted above, however, automated systems often update the TPC database for collection employees. *See*, *e.g.*, IRM 5.1.1.10, *Third Party Contacts* (May 15, 2014); ICS Users Guide at 10-31 and 29-11 (Jan. 2015). The IRS does not measure whether employees ask taxpayers for specific information before making TPCs to obtain it.

66 Under IRC § 7609(a), the IRS must provide the taxpayer a copy of a third-party summons within three days of serving it on the third party and no later than the 23rd day before the third party has to produce the records or testimony. The IRS could use the three day period to determine if the TPC is exempt from the TPC notice and reporting requirements (*e.g.*, because of the potential for reprisal).

cases where the IRS needs to verify information already provided by the taxpayer, TPCs will be more intrusive than necessary unless the IRS gives the taxpayer a reasonable opportunity to provide information needed to avoid the TPC. No such reasonable opportunity exists if the taxpayer does not know the specific information the IRS needs or is not given enough time to respond.

The IRS's current third party contact procedures dilute five of the ten taxpayer rights adopted by the IRS.

Moreover, Pub 1 states that taxpayers have the *right to challenge the IRS's position and be heard*, which includes 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." If the IRS does not inform the taxpayer about what specific information it plans to seek from third parties (or does not provide the taxpayer enough time to respond), then the taxpayer does not have a realistic opportunity to raise objections or provide additional documentation for the IRS to consider.

In furtherance of the *rights to be informed*, *to privacy*, and *to challenge the IRS's position and be heard*, the IRS should include with the TPC notice a request for information, which would make the TPC unnecessary, except where the IRS employee documents why a TPC notice exception applies. Before making a TPC, the IRS should send the taxpayer a TPC notice that asks for the specific information it is planning to request from a third party (except in cases where such a request would be unproductive, such as where it needs to verify information already provided). It should not make the TPC if the taxpayer responds by providing (or agreeing to provide) the information within a reasonable period. It should also send taxpayers periodic reports of TPCs, as required by IRC § 7602(c)(3).

These recommendations are also consistent with the taxpayer's *right to a fair and just tax system*. Empowering only some taxpayers but not others to exercise their rights to avoid TPCs (*e.g.*, by letting them know what information they could provide to avoid it) or learn about TPCs (*e.g.*, by describing how to request TPC reports) is inconsistent with the *right to a fair and just tax system*.

In addition, Pub 1 states that the taxpayer's *right to confidentiality* includes the right to "expect that any information they provide to the IRS will not be disclosed unless authorized... [and] to expect that appropriate action will be taken against employees... who wrongfully use or disclose return information." IRS employees are only "authorized" to make TPCs, which necessarily disclose confidential taxpayer information, if they comply with the TPC notice requirements. Yet, the IRS's internal controls do not ensure it knows when employees wrongfully disclose confidential information by making TPCs that do not comply with IRC § 7602(c). Thus, the IRS's current TPC procedures dilute five of the ten taxpayer rights adopted by the IRS.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Include with a TPC notice a specific request for information that would make the TPC unnecessary, except where the IRS employee documents that a TPC notice exception applies or that requesting the information from the taxpayer would be pointless (*e.g.*, because the IRS needs to verify information already provided).[67]
2. Allow the taxpayer at least ten days to provide the information being requested before making the third party contact to obtain it.[68]
3. Send the taxpayer a copy of any written request for information from a third party within three days of any non-exempt contact (except in collection cases), as the IRS does in connection with third-party summonses.[69]
4. Provide taxpayers with periodic TPC reports of TPCs not already provided (if any), as required by IRC § 7602(c)(3).[70]
5. Modify TPC notices to inform taxpayers of their right to receive post-TPC reports periodically and to explain how to request these reports.
6. Require employees to document the basis (*i.e.*, "good cause") for the reprisal and other exceptions to TPC reporting, require supervisory review of such documentation, and train employees on how to apply them.[71]
7. Improve measures to ensure management knows when and how employees are not following TPC procedures.[72] For example, the IRS's reviews should regularly compare TPCs reflected in the administrative file to those reported to TPC coordinators (*e.g.*, through supervisory, quality, or operational reviews) and require TPC coordinators to acknowledge receipt of these forms. To facilitate these reviews, the IRS may need to require employees to include information on the Form 12175 that it can tie back to the TPCs referenced in the administrative file in cases where a reporting exception applies (*e.g.*, reprisal).

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67 The IRS could return to its prior practice of using Letter 3164-G (DO), (Exam-3) Third Party Contact Letter, and Letter 3164-F (DO), *(Exam-2) Third Party Contact Letter*, for this purpose.

68 In the context of an examination, a taxpayer is notified when the Service issues a third-party summons, and the Service is required to wait 23 days before taking the summoned records. IRC § 7609(a). A collection summons is excepted from those procedures by IRC § 7609(c) to prevent the taxpayer from relocating and hiding assets. H.R. Rep. 94-658, 94th Cong., 2nd Sess. at 3206 (1976). In collection cases, however, the IRS still allows at least ten days for the production of summoned records. *See* IRM 25.5.3.4, *Time and Place of Examination Set by Summons* (July 11, 2013).

69 In collection cases, the taxpayer could still mitigate the damage resulting from the contacts by requesting a TPC list.

70 Such periodic TPC reports would be unnecessary if the IRS had already reported all TPCs to the taxpayer, as recommended.

71 The supervisory review and training would ensure employees are familiar with the TPC rules, including IRM 25.27.1.3.3(4), which requires them to describe good cause in the case history by documenting "the facts surrounding the reason for the reprisal determination" and that they do not apply the exception based solely on an unexplained request by a third party for his or her name to be left off of the list of contacts provided to the taxpayer. *See, e.g.*, Treas. Reg. § 301.7602-2(f)(3)(ii) (Ex. 1) (explaining a "contact is not excepted from the statute merely because the… [third party] asks that his name be left off the list of contacts."). An SB/SE review supports the need for training. It found that a focus group of field examiners had not received any refresher TPC training and could answer polling questions about what is or is not a TPC only 84 percent of the time; and SB/SE's case reviews found that examiners did not document consideration of the potential for reprisal in any cases SB/SE reviewed. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 5-6 (Oct. 30, 2015).

72 Similarly, an SB/SE review recommended the addition of a new reason code to the Exam Quality Measurement System (EQMS) to track adherence to TPC procedures. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 8 (Oct. 30, 2015).

Appendix: Third Party Contact Sampling Methodology and Data Collection Instrument

Methodology

TAS identified a stratified random sample of 1,200 taxpayers whose cases were closed in field exam (600 cases) or field collection (600 cases) in FY 2013. The sample was larger than necessary to project the results to IRS cases nationwide because TAS expected that some case files would not be retrieved in time to complete the study. In addition, TAS oversampled the types of cases (identified by activity code and project code) deemed most likely to involve TPCs so that the sample would yield more precise estimates about how the IRS handles the relatively small percentage of cases that require TPCs.[73] Five TAS Revenue Agent Technical Advisors (RATAs) and four TAS Revenue Officer Technical Advisors (ROTAs) ordered the administrative files and a copy of the IRS's TPC database (*i.e.*, data available on IDRS) for these randomly selected cases. After TAS identified the subset of cases where taxpayers requested TPC lists, it planned to request information about the IRS's responses (*e.g.*, Letter 3173) in these cases from the IRS. However, TAS did not identify any cases where the taxpayer requested a TPC list. The ROTAs and RATAs recorded their findings on an electronic data collection instrument (DCI). TAS research tabulated the data. These results are analyzed in the body of the Most Serious Problem (MSP) above.

Data Collection Instrument

The DCI used by TAS reviewers included the following questions:

1. Did the RA/RO make any third party contacts (TPC)?
2. Were all of the TPCs exempt from the notice and reporting requirements (*e.g.*, authorized on Form 12180, criminal investigation, risk of reprisal, collection in jeopardy, matter in litigation, and certain contacts with contractors, informants, or government officials)?
3. On what date was the first non-exempt TPC?
4. Did the IRS send the taxpayer a TPC notice (*e.g.*, Pub 1, Letters 3164, 3230, 3232, 3234, 3236, 3238, 3345, 3404, 4464, or Notice 1219)?
5. If the RA/RO sent a TPC notice, did the RO/RA wait until the (a) confirming receipt of the TPC notice or (b) at least ten calendar days after sending the TPC notice before making the first non-exempt TPC (as required by IRM 4.11.57.4.1.1.1 and IRM 25.27.1.3.1)?
6. Did the RA/RO ask the taxpayer for the information before requesting it from a third party? (For example, a formal request for specific information through personal contact or letter.)
7. Did the RA/RO determine a "reprisal" TPC reporting exception applied (as provided by IRC § 7602(c)(3), IRM 25.27.1.3.3, or IRM 4.11.57.4.2.3)?
8. If the RO/RA determined the reprisal exception applied, did the RA/RO document the reason(s) why?

73 Field exam cases consisted of two strata: one with certain activity codes and project codes, and the other with the remaining field exam cases. Field collection cases were divided into six strata: (1) individual closed as full paid or with an installment agreement, (2) individual closed as currently not collectible, (3) individual trust fund recovery penalty, (4) individual referred to exam and closed as full paid or with an installment agreement, (5) small business closed as full paid or with an installment agreement, and (6) small business closed as currently not collectible. Each strata was weighted to reflect the proportion of that strata in the population.

9. Does the admin file (case activity record (CAR), Forms 12175, Integrated Collection System (ICS), or memo of interview (MOI)) show one or more non-exempt TPCs that are not reflected on the TPC Coordinator database?
10. Why were one or more TPCs omitted from the TPC database? [Choices included "Form 12175 not completed" or "other" with an explanation.]
11. Did the taxpayer request a TPC list? [yes/no and date recorded]
12. If the taxpayer requested one or more TPC list(s), did the IRS always mail/fax the list (*e.g.*, Letter 3173) within 10 working days (per IRMs 4.11.57.4.6 and 25.27.1.5)?
13. If the IRS sent a TPC list, were there non-exempt TPCs in the admin file that were omitted from the list and not previously disclosed to the taxpayer (*e.g.*, in response to a prior request or on a third-party summons or CDP notice)?

Sample Results

The tables below summarize the results of TAS's sample, which are discussed in the MSP (above). The "counts" reflect the number of times a result was observed in the sample. Because TAS did not review all of the IRS's cases, the "estimate" column reflects how many times we would expect a particular result to occur in the overall population of IRS cases. The results from the sample were weighted so that the extent to which TAS over or under-sampled a particular project code did not bias the results. The upper and lower bounds of the "95% Confidence Interval" shows how close the estimate is likely to be to the true value for the entire population of IRS exam or collection cases at 95 percent level of confidence.[74] This range is generally wider for questions that were not answered very often (*i.e.*, for which the sample has relatively few data points) because the estimates become more precise when you have more data points.

1. Did the RA/RO make any third party contacts (TPC)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	No	31.9%	2.5%	27.2%	37.0%	151
	Yes	68.1%	2.5%	63.0%	72.8%	272
	Total					**423**
Field Exam	No	91.5%	1.5%	88.1%	94.1%	435
	Yes	8.5%	1.5%	5.9%	11.9%	50
	Total					**485**

74 Unless otherwise indicated, TAS assumed reviewers only left questions blank if they could not determine how to answer them based on the information in the case file.

2. Were all of the TPCs exempt from the notice and reporting requirements (*e.g.*, authorized on Form 12180, criminal investigation, risk of reprisal, collection in jeopardy, matter in litigation, and certain contacts with contractors, informants, or government officials)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	0.3%	0.3%	0.1%	1.9%	2
	No	96.3%	1.2%	93.1%	98.1%	261
	Yes	3.4%	1.2%	1.7%	6.6%	9
	Total					**272**
Field Exam	Missing	4.0%	3.9%	0.6%	23.7%	1
	No	47.2%	9.3%	30.0%	65.1%	23
	Yes	48.8%	9.3%	31.4%	66.5%	26
	Total					**50**

4. Did the IRS send the taxpayer a TPC notice (*e.g.*, Pub 1, Letters 3164, 3230, 3232, 3234, 3236, 3238, 3345, 3404, 4464, or Notice 1219)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	3.6%	1.3%	1.8%	7.2%	8
	No	0.8%	0.6%	0.2%	3.2%	3
	Yes	95.5%	1.4%	91.8%	97.6%	250
	Total					**261**
Field Exam	Missing	1.1%	1.2%	0.2%	8.2%	1
	Yes	98.9%	1.2%	91.8%	99.8%	22
	Total					**23**

5. If the RA/RO sent a TPC notice, did the RO/RA wait until the (a) confirming receipt of the TPC notice or (b) at least ten calendar days after sending the TPC notice before making the first non-exempt TPC (as required by IRM 4.11.57.4.1.1.1 and IRM 25.27.1.3.1)?[75]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	72.1%	3.0%	65.8%	77.7%	180
	No	5.3%	1.5%	3.0%	9.2%	14
	Yes	22.5%	2.8%	17.5%	28.6%	56
	Total					**250**
Field Exam	No	2.3%	1.7%	0.5%	9.7%	2
	Yes	97.7%	1.7%	90.3%	99.5%	20
	Total					**22**

6. Did the RA/RO ask the taxpayer for the information before requesting it from a third party? (For example, a formal request for specific information through personal contact or letter)[76]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	14.0%	2.3%	10.1%	19.1%	39
	No	11.1%	2.0%	7.8%	15.6%	34
	Yes	75.0%	2.8%	69.1%	80.1%	199
	Total					**272**
Field Exam	Missing	22.2%	7.9%	10.4%	41.3%	9
	No	22.8%	7.9%	10.8%	41.7%	10
	Yes	55.0%	9.3%	36.8%	71.9%	31
	Total					**50**

75 TAS reviewers left this question (Q5) blank if the RO/RA did not send the taxpayer a TPC letter, even if some other part of the IRS had done so.

76 A very broad request for information from the taxpayer that might technically have covered the information later included in the specific request to the third party was scored as "NO" (for Q6) if it would not have occurred to the taxpayer to provide such information because the IRS did not identify what it wanted with enough specificity.

7. Did the RA/RO determine a "reprisal" TPC reporting exception applied (as provided by IRC § 7602(c)(3), IRM 25.27.1.3.3, or IRM 4.11.57.4.2.3)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	25.1%	2.8%	20.0%	31.0%	71
	No	72.9%	2.9%	66.9%	78.1%	195
	Yes	2.0%	0.8%	0.9%	4.5%	6
	Total					**272**
Field Exam	Missing	8.6%	5.4%	2.3%	26.9%	3
	No	87.4%	6.5%	68.6%	95.7%	46
	Yes	4.0%	3.9%	0.6%	23.7%	1
	Total					**50**

8. If the RO/RA determined the reprisal exception applied, did the RA/RO document the reason(s) why?[77]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	No	100.0%	0.0%	100.0%	100.0%	6
	Total					**6**
Field Exam	No	100.0%	0.0%	100.0%	100.0%	1
	Total					**1**

9. Does the admin file (case activity record (CAR), Forms 12175, Integrated Collection System (ICS), or memo of interview (MOI)) show one or more non-exempt TPCs that are not reflected on the TPC Coordinator database?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	No	51.5%	3.3%	44.9%	58.0%	137
	Yes	48.5%	3.3%	42.0%	55.1%	124
	Total					**261**
Field Exam	No	57.9%	13.4%	31.8%	80.2%	12
	Yes	42.1%	13.4%	19.8%	68.2%	11
	Total					**23**

77 To improve consistency, TAS had a single reviewer examine each of the seven field collection cases. In the absence of any indication the third party actually feared reprisal, documentation that a third party "did not want to be named" was not treated as a documented reason for a reprisal determination. Similar verbiage was present in three of the collection cases TAS reviewed, but there was no express indication this was the basis for the determination. Thus, TAS avoided inferring that the RO applied the reprisal rules incorrectly. *See, e.g.*, Treas. Reg. § 301.7602-2(f)(3)(ii) (Ex.1) (explaining a "contact is not excepted from the statute merely because the… [third party] asks that his name be left off the list of contacts."). Rather, TAS assumed the RO had other undocumented reasons for making the reprisal determination.

10. Why were one or more TPCs omitted from the TPC database?[78]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Form 12175 Not Used	34.5%	4.6%	26.1%	44.0%	43
	Pick List Not Used	57.2%	4.7%	47.7%	66.2%	70
	Other	8.3%	2.5%	4.4%	14.9%	11
	Total					**126**
Field Exam	Form 12175 Not Used	94.5%	4.3%	76.9%	98.9%	9
	Other	5.5%	4.3%	1.1%	23.1%	2
	Total					**11**

11. Did the taxpayer request a TPC list?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	0.8%	0.6%	0.2%	3.2%	3
	No	99.2%	0.6%	96.8%	99.8%	258
	Total					**261**
Field Exam	No	100.0%	0.0%	0.0%	100.0%	23
	Total					**23**

78 Because TAS reviewers frequently indicated that the "other" reason was that ROs did not select the correct pick list item, TAS compiled and reported these results separately.

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

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TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

In 2006, in the light of empirical evidence that audits initiated on the basis of whistleblower information resulted in the recovery of hundreds of millions of dollars of unpaid tax and cost less than half, per dollar of taxes collected, of other Internal Revenue Service (IRS) enforcement programs, Congress concluded that "rewarding whistleblowers is one of the best ways to fight tax cheats."[2] The legitimate use of whistleblowers, however, creates risks for the subject of the whistleblower claim, especially when the claim is unsupported or not pursued. As Congress is aware, voluntary compliance may be undermined if taxpayers perceive the IRS is not adequately guarding their tax information.[3] It is possible to balance these two

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2006-30-092, *The Informants' Rewards Program Needs More Centralized Management Oversight* 3-4 (June 6, 2006) (describing the contents of IRS, *The Informants' Project: A Study of the Present Law Reward Program* (Sept. 1999)); *Grassley Says IRS, Treasury Need to Put Out "Welcome Mat" for Whistleblowers*, 2006 TNT 112-96 (June 12, 2006).

3 See Dept. of Treas., *Report to The Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions*, Vol. I, Study of General Provisions 34 (Oct. 2000) (stating that "[t]axpayers who view the IRS as a resource for a variety of other interests will be less inclined to voluntarily turn over sensitive financial information out of fear of where it might ultimately land").

concerns; however, the whistleblower program as currently administered by the IRS and the Internal Revenue Code (IRC) do not adequately strike that balance.

The legitimate use of whistleblowers, however, creates risks for the subject of the whistleblower claim, especially when the claim is unsupported or not pursued. As Congress is aware, voluntary compliance may be undermined if taxpayers perceive the IRS is not adequately guarding their tax information.

The IRS has long had the authority, at its own discretion, to compensate informants who report violations of the internal revenue laws.[4] Using this discretion, now codified as subsection (a) of IRC § 7623, the IRS adopted a policy of paying informants up to 15 percent of the amount recovered, subject to a $10 million cap.[5] In 2006, Congress added subsection (b) to IRC § 7623, significantly expanding the scope of the statute by *requiring* the IRS to award certain whistleblowers an amount between 15 and 30 percent of the collected proceeds, with no maximum dollar limit.[6]

Whistleblowers took an immediate interest in IRC § 7623(b), making 50 submissions in fiscal year (FY) 2007 that appeared to meet the threshold requirements, including that the amount in dispute exceed $2 million.[7] The number of submissions under IRC § 7623(b) increased dramatically thereafter; there were 352 in FY 2014 alone.[8] The IRS paid the first IRC § 7623(b) award in 2011 and paid 11 such awards from FYs 2011 to 2014.[9] The total amount of awards under IRC § 7623 was $13.6 million in FY 2007 (when the IRS paid claims only at its discretion, under IRC § 7623(a)) and fluctuated over the years, reaching a high of $125 million in FY 2012 (when the IRS paid claims under both subsections).[10]

Despite the increased willingness of whistleblowers to come forward, the effectiveness of the whistleblower program has been undermined by conditions such as:

- The length of time it takes to resolve whistleblower cases, which averaged almost six years for awards paid in FY 2014;[11]
- Statutory provisions that impede the IRS from communicating effectively and regularly with whistleblowers; and

4 *See* Act of Mar. 2, 1867, ch. 169, §7, 14 Stat. 471, 473 (codified by ch.11, § 3463, 35 Rev. Stat. 686 (1893-74)).

5 IRC § 7623(a); Internal Revenue Manual (IRM) 1.2.13.1.12, *Policy Statement 4-27* (Aug. 13, 2004).

6 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2921, 2958 (adding subsection (b) to IRC § 7623); IRC § 7623(b)(1). The IRS does not take into account penalties collected for failing to file Form TD F 90-22.1 (now FinCEN Form 114), *Report of Foreign Bank and Financial Accounts (FBAR)*, as required by 31 U.S.C. § 5314 in making awards under IRC § 7623. *See* Legislative Recommendation: *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*, *infra*.

7 IRS Whistleblower Office (WO), *Fiscal Year 2011 Report to the Congress on the Use of Section 7623*, Table 1; IRC § 7623(b)(5)(B). As the WO annual reports note, the number of submissions reported was subject to change. For this reason, we cite to the most recent report for which the cited data is available.

8 IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623*, Appx. Table 2.

9 *Id*. at 4.

10 IRS WO, *Fiscal Year 2011 Report to the Congress on the Use of Section 7623*, Table 4; IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623*, Appx. Table 6.

11 IRS WO response to TAS information request (Aug. 27, 2015) (noting that 101 awards were paid in FY 2014, with an average elapsed time from Form 211 receipt to award payment date of 5.8 years). The timeframes ranged from 2.4 years to 14.8 years, with a median of 5.3 years. For the 11 awards paid under IRC § 7623(b) from FYs 2011-2014, the average elapsed time from Form 211 receipt to award payment date was 4.9 years. The timeframes ranged from 3.9 years to 6.1 years, with a median of 4.9 years.

- The lack of statutory protection of whistleblowers from retaliation.[12]

Moreover, the whistleblower program does not adequately protect taxpayers from disclosure of their confidential information by whistleblowers. The causes of some of these difficulties are beyond the IRS's control, and the IRS shares some of the National Taxpayer Advocate's concerns.[13] However, the IRS has moved slowly to address issues within its purview, and has occasionally exacerbated the difficulties.[14] The whistleblower program enjoys the support of the IRS Commissioner but has yet to realize its full potential.[15]

ANALYSIS OF PROBLEM

Accepting Assistance From Whistleblowers Is an Efficient Enforcement Mechanism But Carries Heightened Risk for the Subject of the Claim

The IRS selects returns for audit in a variety of ways, most often using Discriminant Index Function (DIF) formulas.[16] In 1999, the IRS reported that audits of 1996-1998 returns initiated on the basis of information from an informant (now referred to as a whistleblower) "had a higher dollar yield per hour[17] and a lower no-change[18] rate" than returns selected on the basis of DIF scores.[19] Moreover, the cost/benefit ratio of whistleblower audits compared favorably with other IRS enforcement programs: "[t]he report estimated the IRS incurred slightly over four cents in cost (including personnel and administrative costs) for each dollar collected from the Informants' Rewards Program (including interest), compared to a cost of over ten cents per dollar collected for all enforcement programs."[20] From FYs 2001-2005, audits based on whistleblower information resulted in a total recovery of tax, fines, interest and penalties of more than $340 million.[21]

When the IRS accepts assistance from a whistleblower, the risk arises that the audited taxpayer's confidential information will be inappropriately disclosed to the whistleblower, a risk for which Congress and the IRS have little tolerance. IRC § 6103 generally prohibits IRS employees from disclosing a taxpayer's

12 The Government Accountability Office (GAO) has voiced similar concerns. See GAO, GAO-16-20, *IRS Whistleblower Program Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* (Oct. 2015).

13 *See* IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* 6-7.

14 See the discussion below pertaining to the IRS's refusal to enter into tax administration contracts with whistleblowers, its determination that an "administrative proceeding" begins when the IRS proposes an award, and the inadequacy of confidentiality agreements executed by whistleblowers to deter re-disclosure of taxpayer information.

15 *See, e.g.*, William Hoffman, *Tax Analysts Interview with John Koskinen* (Oct. 17, 2014) (reiterating his support for the whistleblower program generally, expressing his willingness to explore ways to improve communication with whistleblowers, and noting the need for anti-retaliation legislation).

16 *See* IRM 4.22.1.5, *Benefits of NRP* (Oct. 1, 2008); IRM 4.19.11.1.5.1, *How DIF Works* (Nov. 9, 2007) (explaining, among other things, that "DIF is a mathematical technique used to score income tax returns as to examination potential").

17 Dollar yield per hour refers to the total recommended adjustments to tax liability divided by the number of examiner hours charged to examinations. (fn. in original.)

18 For the purpose of this analysis, an examination of a return results in a "no-change" when the examination is closed in the Audit Information Management System (AIMS) using Disposal Code 02 (no adjustments or changes to tax liability). (fn. in original.)

19 TIGTA, Ref. No. 2006-30-092, *The Informants' Rewards Program Needs More Centralized Management Oversight* 4 (June 6, 2006) (describing the contents of IRS, *The Informants' Project: A Study of the Present Law Reward Program* (Sept. 1999)).

20 *Id*.

21 *Id*. at 3

"return" or "return information" and civil and criminal penalties are imposed for violating the bar.[22] The broad definitions of "return" and "return information" forbid the IRS from telling a whistleblower, for example:

- Whether the claim led to an audit;
- Why a claim did not lead to an audit;
- Whether an audit resulted in assessment of additional tax; or
- The extent to which any additional tax was collected.[23]

The following statutory provisions allow taxpayers to recover damages for unauthorized disclosures and permit imposition of fines and prison terms, in addition to requiring termination of employment if the violator was a federal employee:

- IRC § 7431 generally allows a taxpayer whose return or return information was knowingly or negligently disclosed to bring a civil action for statutory damages of $1,000 or actual damages;[24]
- IRC § 7213 imposes a fine of up to $5,000 and imprisonment of up to five years for willful disclosure of return or return information;[25] and
- IRC § 7213A imposes a fine of up to $1,000 and imprisonment for up to one year for willful unauthorized inspection of a taxpayer's return or return information.[26]

Additionally, IRC § 6103(p) imposes requirements that pertain generally to appropriate storage and secure access of return information and requires the specified possessor to "provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information."[27]

22 IRC § 6103(a) prohibits the IRS from disclosing taxpayers' returns or return information absent an exception. There are 13 exceptions found in IRC § 6103(c)-(o), none of which expressly allows disclosures to whistleblowers. IRC § 6103(b)(1) defines "return" as "any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed." IRC § 6103(b)(2)(A) defines "return information" to include "a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense."

23 As the IRS advises, "[o]nce a claim is submitted, the informant may be told only the status and disposition of the claim — not the action taken in the taxpayer case. We can say whether the claim is still open or has been closed. If closed we can say that a claim is payable (and the amount) or that the claim is denied." *Confidentiality and Disclosure for Whistleblowers*, *available at* www.irs.gov/uac/Confidentiality-and-Disclosure-for-Whistleblowers.

24 IRC § 7431(a)(2), (c) (imposing the same penalties for unauthorized inspection and for disclosure). In addition, the *Taxpayer Bill of Rights Enhancement Act of 2015*, § 202, S. 1578, introduced on June 16, 2015, would increase the statutory damage amount to $5,000 for each instance of unauthorized inspection and $10,000 for each instance of unauthorized disclosure, among other things.

25 IRC § 7213(a)(1) (also providing that a federal employee who violates IRC § 7213 "shall, in addition to any other punishment, be dismissed from office or discharged from employment upon conviction for such offense"). In addition, the *Taxpayer Bill of Rights Enhancement Act of 2015*, § 201, S. 1578, introduced on June 16, 2015, would increase the maximum fine for unauthorized disclosure to $20,000.

26 IRC § 7213A(a)(1)(B), (b)(1). A federal employee "who is convicted of any violation of subsection (a) shall, in addition to any other punishment, be dismissed from office or discharged from employment." IRC § 7213A(b)(2). In addition, the *Taxpayer Bill of Rights Enhancement Act of 2015*, § 201, S. 1578, introduced on June 16, 2015, would increase the maximum fine for unauthorized inspection to $5,000.

27 IRC § 6103(p)(4)(D).

The National Taxpayer Advocate has long been a proponent of enforcing and extending (where appropriate) these statutory sanctions and safeguarding provisions.[28]

Although Similar to Whistleblower Provisions of the False Claims Act, the Tax Whistleblower Statute Differs in Important Respects

In 1863, Congress enacted the False Claims Act (FCA) to address the rampant fraud on the government perpetrated during the Civil War.[29] Under the FCA, the United States Attorney General and the Department of Justice (DOJ) are delegated the discretion to bring a civil suit for statutory penalties and damages on the basis of an informant's information, but if the government declines to proceed with the action, the informant may continue alone as a *qui tam* plaintiff in the name of the government.[30] Prior to 1987, courts had discretion to award the informant up to ten percent of the proceeds collected if the government brought suit, and up to 25 percent of the proceeds collected, as well as the reasonable expenses for the costs of litigation, if the government declined to proceed and an individual brought the action.[31] In 1987, amendments to the FCA strengthened the *qui tam* provisions by *requiring* payments to the informant of between 15 and 25 percent of the proceeds if the government brought suit, or 25 to 30 percent if the informant proceeded alone, and adding protections from retaliation for employee whistleblowers.[32] The amendments also included a "tax bar," which codified prior court holdings that tax fraud is excluded from the purview of the FCA.[33]

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28 *See* National Taxpayer Advocate 2003 Annual Report to Congress 232-54 (recommending that "[d]uring pilots and in statutory disclosures, agencies and their contractors must be subject to the safeguard provisions of IRC § 6103(p)(4), and agencies and their contractors or agents must be subject to the civil and criminal sanctions of IRC §§ 7213, 7213A, and 7341"); National Taxpayer Advocate 2010 Annual Report to Congress 396 (recommending that taxpayers be allowed to recover damages for unauthorized disclosure by whistleblowers). The President's Budget submissions for FYs 2014-2016 included legislative proposals to amend IRC § 6103 "to provide that the section 6103(p) safeguarding requirements apply to whistleblowers and their legal representatives who receive returns and return information in whistleblower administrative proceedings. In addition, the proposal extends the penalties for unauthorized inspections and disclosures of returns and return information to whistleblowers and their legal representatives." *See General Explanations of the Administration's Fiscal Year Revenue Proposals* (Treasury Greenbook) FYs 2014-2016 at 205, 236, and 250-51, respectively, *available at* www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. As discussed below, the National Taxpayer Advocate this year recommends that Congress make the safeguarding provisions and statutory sanctions applicable to whistleblowers. *See* Legislative Recommendation: *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)*, *infra*.

29 H.R. Rep. No. 99-660, at 17 (1986).

30 31 U.S.C. § 3730(a), (b); 31 U.S.C. § 3729. *Qui tam* is "[a]n action brought under a statute that allows a private person to sue for a penalty, part of which the government or some specified public institution will receive." Black's Law Dictionary (9th ed. 2009). The private person who brings a *qui tam* action is the "relator." According to one 2011 DOJ memo, "[t]here are no statistics reported on the length of time the average *qui tam* case remains under seal [the preliminary period during which DOJ investigates a FCA complaint and decides whether it will intervene]… In this District, most intervened or settled cases are under seal for at least two years (with, of course, periodic reports to the supervising judge concerning the progress of the case, and the justification of the need for additional time)." See *False Claims Act Cases: Government Intervention in Qui Tam (Whistleblower) Suits* 2, *available at* http://www.justice.gov/sites/default/files/usao-edpa/legacy/2011/04/18/fcaprocess2_0.pdf. The length of time the suit will take appears to vary widely. *See, e.g.*, Ben Hallman, *Whistleblowers, Beware: Most Claims End in Disappointment, Despair*, *available at* http://www.huffingtonpost.com/2012/06/04/whistleblower-law-false-claims-act-awards-james-holzrichter_n_1563783.html, reporting on FCA suits that took as long as 17 years to resolve, as well as one that took less than a year to resolve.

31 *See* Pub. L. 97-258, § 3730(c)(1) and (2), 96 Stat. 877, 978.

32 *See* False Claims Amendment Act of 1986, Pub. L. 99-562, Sec. 3, § 3730(d)(2), 100 Stat. 3153, 3154-3157.

33 31 U.S.C. § 3729(d). As one commenter observed, "[s]ince the [False Claims Act] deals only with misrepresentations made in connection with the presentation of claims, misrepresentations for the purpose of defrauding the Government are in many situations not proscribed. The Supreme Court [in *United States v. Cohn*, 270 U.S. 339 at 345] has defined a 'claim' as a demand upon the Government for the payment of money or delivery of property… However, where the citizen uses false statements to reduce his own liability to the Government, the statute is inapplicable" (fn. refs. omitted). Note, *The False Claims Act*, 69 Harv. L. Rev. 1106 (1956).

Although there is room for improvement in the cycle time of whistleblower cases, these cases are often complex and involve built-in time constraints and waiting periods.

The "tax informant statute," now codified as IRC § 7623, was enacted in 1867.[34] Prior to 2006, payments to tax whistleblowers were not mandatory (like payments under the FCA prior to 1986); whether to pay an award and the amount of any award were within the IRS's discretion.[35] In 2006, following a Treasury Inspector General for Tax Administration (TIGTA) report identifying weaknesses in the whistleblower program, Congress added subsection (b) to IRC § 7623.[36] The 2006 amendments made whistleblower awards mandatory in certain cases, specified an award amount from 15 to 30 percent of the collected proceeds (with no cap on the amount of the award), created the IRS Whistleblower Office (WO), and provided for United States Tax Court review of whistleblower award determinations.[37] The IRS and Treasury drafted proposed regulations implementing IRC § 7623(b) in 2012, and after notice, public comment, and a public hearing, issued final regulations in August 2014.[38]

Under IRC § 7623, a tax whistleblower's statutory role has always been limited to reporting information to the IRS, which, like the Attorney General for purposes of the FCA, has the discretion to pursue the claim or not.[39] Unlike the FCA, there is no *qui tam* provision in the IRC allowing a tax whistleblower to proceed on behalf of the government, and tax whistleblowers do not have the benefit of statutory protections from retaliation.[40] Tax whistleblowers are protected by statute from having their identities disclosed in certain situations, however, and the IRS provides heightened security for whistleblower information

34 *See* Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473 (codified by ch.11, § 3463, 35 Rev. Stat. 686 (1893-74)).

35 As noted above, the IRS adopted a policy of paying informants up to 15 percent of the amount recovered, subject to a $10 million cap. IRM 1.2.13.1.12, *Policy Statement 4-27* (Aug. 13, 2004).

36 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2922, 2958. *See* Joint Committee on Taxation, Technical Explanation of H.R. 6408, the "Tax Relief and Health Care Act of 2006," JCX-50-06, No. 2 (Dec. 7, 2006) (referencing TIGTA, Ref. No. 2006-30-092, *The Informants' Rewards Program Needs More Centralized Management Oversight* (June 6, 2006)).

37 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 406(b), 120 Stat. 2922, 2959 (an "off-Code" provision creating the WO); IRC § 7623(b)(4) (providing for Tax Court review of the IRS's award determination). For administrative ease, the IRS subsequently changed its policy of awarding only up to 15 percent of the amount recovered for subsection (a) claims, and now applies the same criteria and percentages to subsection (a) claims submitted after July 1, 2010, as for subsection (b) claims. IRM 25.2.2.7.4, *Award Computation - IRC 7623(a) claims filed on or after July 1, 2010 and IRC 7623(b) claims* (Aug. 7, 2015); WO response to TAS information request (Oct. 20, 2015).

38 Notice of Proposed Rulemaking, 77 Fed. Reg. 74798, 2013-3 I.R.B. 289 (Dec. 18, 2012); *Preamble*, T.D. 9687, 79 Fed. Reg. 47246 (Aug. 12, 2014) (noting that the IRS and Treasury held a public hearing on April 10, 2013, at which eight commenters testified).

39 The House proposed including in the 1867 statute a provision allowing *qui tam* actions by informers, but the proposal was rejected, without explanation, by the Senate. *See* Cong. Globe, 39th Cong. 2d Sess. (1867) 1545, 1919. Moreover, a rule similar to the one found in what is now IRC § 7401 (that "[n]o civil action for the collection or recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Secretary authorizes or sanctions the proceedings and the Attorney General or his delegate directs that the action be commenced") was in place prior to enactment of the 1867 tax informant statute (Act of July 13, 1866, ch. 184, § 9, 13 Stat. 111), and was left intact. *See also Cohen v. Comm'r*, 139 T.C. 299, 302 (2012) (holding that "section 7623 [does not] confer authority [on the Tax Court] to direct the Commissioner to commence an administrative or judicial action").

40 The President's Budget submissions for FYs 2014, 2015, and 2016 included legislative proposals to provide whistleblowers with protection from retaliation. *See* Treasury Greenbook FYs 2014-2016 at 204, 235, and 250-51, respectively, *available at* www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. The GAO has also recommended that Congress consider such legislation. *See* GAO, GAO-16-20, *IRS Whistleblower Program Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* 45 (Oct. 2015).

contained in administrative files.[41] Perhaps the biggest difference between the two whistleblower regimes is due to the protection of taxpayers' confidential information afforded by IRC § 6103, discussed above.

It Takes the IRS Almost Five Years on Average to Make Payouts of IRC § 7623(b) Claims

The IRS paid its first whistleblower award pursuant to IRC § 7623(b) in 2011.[42] Although there is room for improvement in the cycle time of whistleblower cases, these cases are often complex and involve built-in time constraints and waiting periods. The process that culminates in an award under IRC § 7623(b) takes close to five years and generally begins with review of Form 211, *Application for Award for Original Information*, by the WO's Initial Claim Evaluation (ICE) Team.[43] The claim is perfected if necessary (*e.g.*, the submitter may be asked to complete an incomplete Form 211 or provide an original signature) and then considered by a classifier in one of the IRS operating divisions.[44] If the classifier, after reviewing Form 211 and completing a classification check sheet, advises the WO that the claim has merit, the WO refers the claim to the appropriate operating division subject matter expert, who reviews the file and advises whether the IRS should open an audit.[45] If an audit ensues, the general progress of the claim includes: the audit itself; collection of any additional tax resulting from the audit; expiration of any period of limitations within which the audited taxpayer could request a refund; determining the amount of the award; and processing payment.[46]

41 *See* IRC § 6103(h)(4) (allowing disclosure of return or return information in judicial and administrative tax proceedings, except where "the Secretary determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation"); Treas. Reg. § 301.7623-1(e) (providing that "[u]nder the informant's privilege, the IRS will use its best efforts to protect the identity of whistleblowers"); IRM 25.2.2.5, *Examining a Whistleblower Claim* (Aug. 7, 2015) (instructing that there be "no mention or discussion of the whistleblower in the regular examination activity log, work papers, or case file" (which the IRS interprets to mean that the existence of a whistleblower, as well as his or her identity, is not to be mentioned). WO response to TAS information request (Oct. 20, 2015)); IRS Notice 2008-4, § 3.06, 2008-2 I.R.B. 253 (providing that the IRS maintains the confidentiality of the whistleblower's identity "to the fullest extent permitted by law").

42 IRS WO, *FY 2011 Report to the Congress on the Use of Section 7623* at 3. The WO's annual reports do not identify, for awards paid, the year in which the claim was submitted.

43 WO response to TAS information request (Aug. 27, 2015) (noting that for the 11 awards paid under IRC § 7623(b) from FYs 2011-2014, the average elapsed time from Form 211 receipt to award payment date was 4.9 years). Timeframes ranged from 3.9 years to 6.1 years, with a median of 4.9 years.

44 IRM 25.2.2.4, *Initial Form 211 Processing* (Aug. 7, 2015). We note that the perception of the independence of the WO's determinations would be enhanced if the classifiers reported to the WO Director, similar to the structure of TAS, where revenue agents and revenue officers bring their skills and experience to TAS, and as TAS employees follow TAS's mission, with their head of office the National Taxpayer Advocate.

45 IRM 25.2.2.4.2, *Selecting a Claim* (Aug. 7, 2015). Alternatively, the classifier may recommend that the WO reject the claim, deny the claim, refer the claim to another group for consideration, or, where the claim requires special handling or coordination among operating divisions, refer the claim(s) to the WO's Case Development and Oversight group, which analyzes and decides whether to send the claim to the field for possible audit. A classifier who recommends not proceeding with the claim must provide documentation showing he or she considered the issue(s) reflected on the Form 211 and provide the reason he or she did not select the claim. WO Procedural Guide, *ICE Process: Classification* 18 (rev. Mar. 27, 2015). A subject matter expert who ultimately determines not to proceed with the case must complete Form 11369, *Confidential Evaluation Report on Claim for Award*, which his or her manager approves, and submit it to the WO Analyst, who forwards it for approval by a WO manager or senior manager. IRM 25.2.2.4.4(8), *Operating Division SME Responsibilities* (Aug. 7, 2015).

46 *See* IRM 25.2.2, *Whistleblower Awards* (Aug. 7, 2015). A claim may be transferred to Criminal Investigation (CI), accompanied by Form 11369 explaining the reason for the transfer, and CI may recommend the claim for prosecution, assist the Tax Division of the DOJ in prosecuting the claim, and at its conclusion, return it to the WO for consideration of an award. IRM 9.4.1.5.1.1(7), *Information Items and Whistleblowers* (Mar. 30, 2012). If CI determines that the referral lacks prosecution potential, it returns the case to WO, which may refer the claim to an operating division for audit consideration. IRM 9.4.1.5.1.1(4), *Information Items and Whistleblowers* (Mar. 30, 2012). A decision by CI to initially not take action does not prevent a criminal referral by an operating division after further development.

Even if performance goals (which do not include the time it takes to conduct the audit) are met or exceeded, and even assuming the claim is never suspended pending the outcome of an appeal, collection action, or similar case developments, it will take more than three and a half years on average for a claim to culminate in an award to the whistleblower.

Performance goals established by the IRS Deputy Commissioner of Services and Enforcement apply to some (but not all) phases of the process.[47] For example, there are no target timeframes for completing whistleblower field audits, which take about a year and a half on average and account for the claims of more than a third of all whistleblowers.[48] Even if performance goals (which do not include the time it takes to conduct the audit) are met or exceeded, and even assuming the claim is never suspended pending the outcome of an appeal, collection action, or similar case developments, it will take more than three and a half years on average for a claim to culminate in an award to the whistleblower.[49] A substantial number of whistleblowers (221 out of 1,489, or about 15 percent) were awaiting the WO's review of audit results to determine whether there is sufficient information to make an award decision, which takes almost a year.[50] The number of days this phase consumes presents an opportunity for the IRS to truncate the cycle time for whistleblower cases and reduce the time whistleblowers must wait to learn whether they will receive an award.[51] Figure 1.13.1 shows the principal phases required in most successful IRC § 7623(b) claims.

47 Memo from John M. Dalrymple, Deputy Commissioner for Services and Enforcement, to Commissioners of the Large Business & International (LB&I), Small Business/Self-Employed (SB/SE), Tax Exempt and Government Entities (TE/GE) divisions, Chief of CI, and Director of the WO (Aug. 20, 2014).

48 CI response to TAS information request (Sept. 3, 2015); TE/GE response to TAS information request (Aug. 5, 2015); SB/SE response to TAS information request (July 30, 2015); LB&I response to TAS information request (July 29, 2015). IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623*, 20,18 Appx. Tables 5, 4 (showing field audits in WB cases take on average 544 days, with 2,344 days (more than six years) the longest audit and that as of May 14, 2015, out of 1,489 whistleblowers with open claims, the claims of 500 whistleblowers (34 percent) were in field audit). Criminal investigations of whistleblower claims take on average close to two years. CI response to TAS information request (Sept. 3, 2015) (noting that the average number of days from the start of an investigation to its completion for investigations closed in FYs 2012, 2013, and 2014 was 572, 656, and 762, respectively).

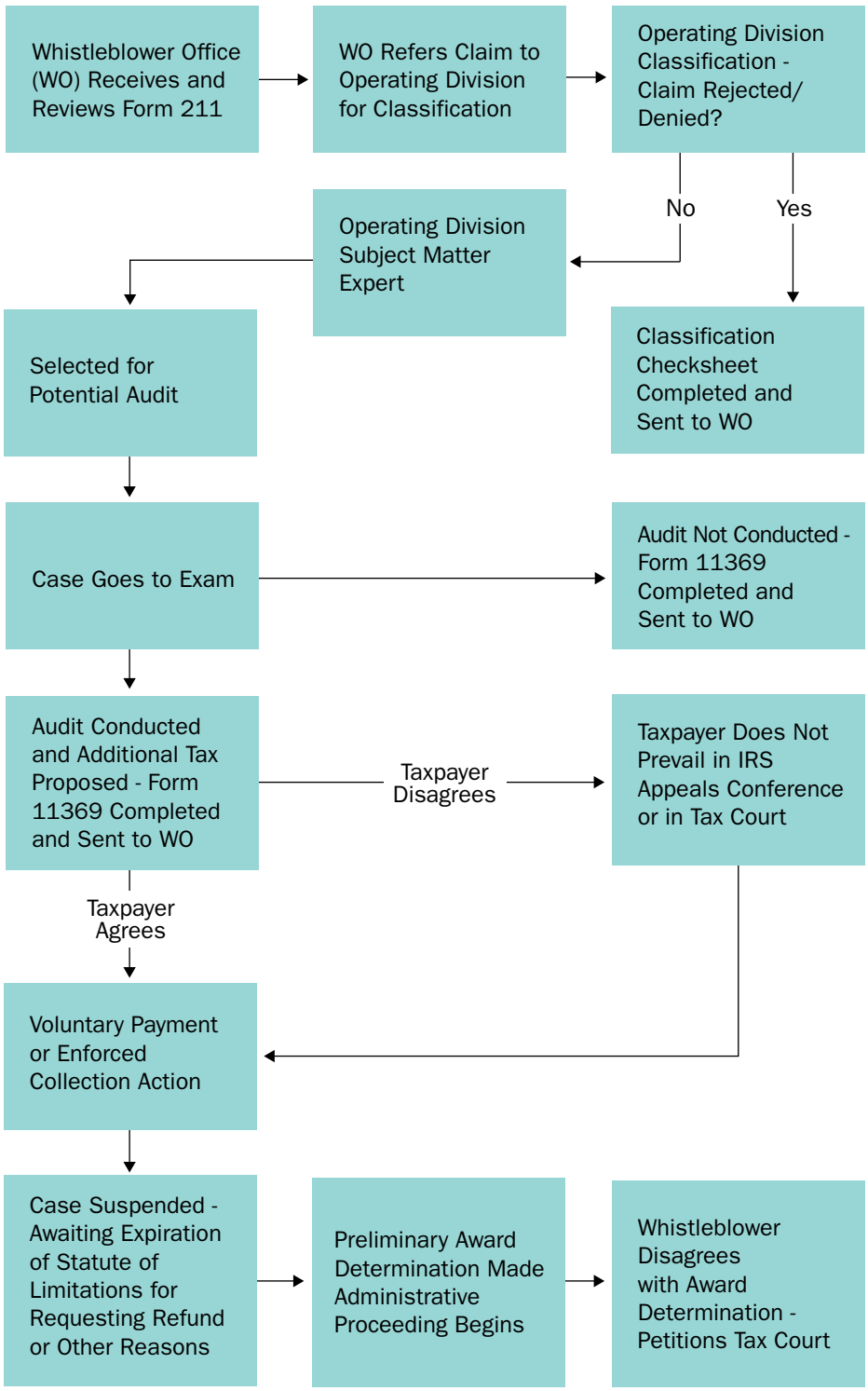
49 The WO is in the process of updating its records to reflect new status categories and expects its future reports to more accurately capture the status of subsection (b) claims. Current data shows that it takes 85 days on average for the WO to complete its initial review of the claim (which is faster than the 90-day target); 80 days on average for operating division subject matter expert review to determine whether to audit (which is also faster than the 90-day target); 544 days on average for operating division OD field examination; 362 days on average for the WO review of the results of field action to determine whether there is sufficient information to make an award decision; 45 days on average for the whistleblower to be notified of award decision after collected proceeds are finally determined (which is faster than the 90-day target); and 218 days for final award processing. The sum of these periods is 1,334 days, more than 3.5 years. IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* 20 Appx. Table 5.

50 *Id.* at 18, 20 Appx. Tables 4 and 5 (noting that this step takes 362 days on average). As noted, the WO is in the process of updating its records. It is possible that some claims included in this step will be re-classified as in another status, which could affect the average number of days claims await the WO's review of audit results. WO response to TAS information request (Oct. 20, 2015).

51 A 90-day time period for this phase would be an appropriate performance goal.

FIGURE 1.13.1

Principal Phases of Most Successful IRC § 7623(b) Claims



If the claim is suspended, which could occur for a variety of reasons, the average timeframe is extended, potentially for several additional years.[52] One important reason for suspending a claim, at least in cases where the taxpayer has not waived the right to request a refund, is to allow the statutory period of limitations for requesting a refund to expire.[53] Suspending the claim obviates the risk that the IRS would pay an award to a whistleblower out of collected proceeds it is later required to refund to the taxpayer. Treasury regulations permit, but do not require the IRS to separate the components of a claim so that a payout on one issue can go forward while other issues are litigated.[54]

Because processing times may be lengthy, whistleblowers seek information about the status of their claims. They approach the WO with requests for information, they submit requests to the IRS under the Freedom of Information Act (FOIA), and they inform TAS of systemic delays.[55]

The IRS Has Never Availed Itself of IRC § 6103(n), an Exception to the Statutory Prohibition on Disclosing Confidential Taxpayer Information, That Would Allow the IRS to Update Whistleblowers on the Status of Their Claims and Protect Taxpayer Confidential Information From Re-Disclosure by the Whistleblower

There are exceptions to the nondisclosure rules of IRC § 6103, some of which may apply in the context of whistleblower claims, although none specifically addresses disclosures to whistleblowers. For example, a whistleblower and the IRS may enter into a contract under IRC § 6103(n), sometimes referred to as a "tax administration" contract, for the whistleblower's services relating to the detection of violations of the internal revenue laws or related statutes.[56] In that event, the IRS "may inform the whistleblower and, if applicable, the legal representative of the whistleblower, of the status of the whistleblower's claim for award under IRC § 7623, including whether the claim is being evaluated for potential investigative action, or is pending due to an ongoing examination, appeal, collection action, or litigation."[57] If a tax administration contract is in effect, the regulations under IRC § 6103 provide that the sanctions imposed by IRC §§ 7431, 7213, and 7213A, discussed above, apply to the whistleblower.[58] Moreover, a whistleblower who executes a contract under IRC § 6103(n) must "permit an inspection of the whistleblower's

52 The shortest average suspension period, arising while the claim is awaiting collection action, affected 76 whistleblowers in FY 2014 and adds about nine months on average to the timeframe. The longest average suspension period, arising while the IRS evaluates a bulk claim involving a large number of taxpayers, affected ten whistleblowers in FY 2014 and adds almost three years to the timeframe. IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* at 17 Appx. Table 4.

53 Generally, taxpayers must request a refund within three years from the date their return was filed, or two years from the time the tax was paid, whichever occurs later, or, if no return was filed, within two years from the time the tax was paid. IRC § 6511(a). If taxpayers meet the three-year requirement, they can recover payments made during the three-year period that precedes the date of the refund request, plus the period of any extension of time for filing the return. Taxpayers who do not meet the three-year requirement can recover only payments made during the two-year period preceding the date of the refund request. IRC § 6511(b)(2).

54 *See* Treas. Reg. § 301.7623-4(d)(2), T.D. 9687, 79 Fed. Reg. 47246, 47275 (Aug. 12, 2014). In any event, Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment*, provides that the consenting taxpayer cannot petition Tax Court, but "[y]our consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are so entitled."

55 From FYs 2012-2015 (as of June 22), the IRS received 38 FOIA requests seeking access to whistleblower records, 11 of which were from whistleblowers seeking access to records about their claim. In those cases, the whistleblower can obtain the claim and any attachments he or she provided to the IRS, and the IRS can confirm that the claim exists and is still open or closed, but cannot provide any other information about actions the IRS will take on the claim. Privacy, Governmental Liaison and Disclosure response to TAS information request (June 29, 2015); SAMS 31265, submitted Aug. 18, 2014.

56 *See* IRC § 6103(n); Treas. Reg. § 301-6103(n)-2.

57 Treas. Reg. § 301.6103(n)-2(b)(3).

58 Treas. Reg. § 301.6103(n)-2(c) (providing "[a]ny whistleblower, or legal representative of a whistleblower, who receives return information under this section, is subject to the civil and criminal penalty provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of the return information").

or the legal representative's premises by the IRS" to ensure that return information is adequately protected from unauthorized disclosure.[59]

The IRS advises its officials they may use an IRC § 6103(n) contract when disclosure to a whistleblower is "necessary to obtain a whistleblower's insights and expertise into complex technical or factual issues,"[60] and as discussed below, the regulations under IRC § 7623 contemplate the use of such contracts.[61] At the same time, the IRS views these contracts as "not intended to be used to disseminate information to whistleblowers."[62] On the contrary, "[a] whistleblower who thinks the IRS will grant a section 6103 contract 'without a compelling need on the part of the IRS to get information from the whistleblower has just misunderstood what (n) contracts were intended to do.'"[63] In any event, the IRS has never entered into an IRC § 6103(n) contract with a whistleblower.[64]

The IRS Does Provide Confidential Taxpayer Information to Whistleblowers Under Provisions That Do Not Adequately Protect Taxpayers from Re-Disclosure of Their Confidential Information by Whistleblowers

The IRS does disclose return information to whistleblowers pursuant to another exception to IRC § 6103 for what are sometimes referred to as "investigative disclosures."[65] Under IRC § 6103(k)(6), to the extent necessary to obtain information related to the IRS's official duties or to accomplish properly any activity connected with such official duties, the IRS may disclose return information to third parties (persons other than the taxpayer). Whether or not this exception would allow the IRS to provide status updates to a whistleblower, a whistleblower to whom a disclosure is made under IRC § 6103(k)(6), unlike a whistleblower to whom a disclosure was made pursuant to an IRC § 6103(n) contract, is not subject to statutory requirements for safeguarding the information or the statutory sanctions for re-disclosing it.[66]

The IRS discloses taxpayer information to a successful whistleblower pursuant to another exception to IRC § 6103 after it concludes an audit, collects proceeds from the taxpayer, determines that a

59 Treas. Reg. § 301.6103(n)-2(d)(3). *See also* Treas. Reg. § 301.6103(n)-1 (providing analogous provisions that apply to tax administration contracts generally (not only those entered into by whistleblowers)).

60 Memorandum from John M. Dalrymple, IRS Deputy Commissioner for Services and Enforcement to Commissioners of the LB&I, SB/SE, TE/GE divisions, Chief of Criminal Investigation, and Director of the Whistleblower Office (Aug. 20, 2014); Memorandum from Steven Miller, IRS Deputy Commissioner for Services and Enforcement to Commissioners of the LB&I, SB/SE, TE/GE and W&I divisions, Chief of Criminal Investigation, and Director of the Whistleblower Office (June 20, 2012), 2012 TNT 121-15.

61 *Preamble*, T.D. 9687, 79 Fed. Reg. 47246, 47256 (Aug. 12, 2014).

62 Andrew Velarde, *Whistleblower Status Letters Seen as a Good Start but Not Enough* 2015 TNT 53-5 (Mar. 19, 2015) (describing the WO Director's view of IRS § 6103(n) contracts).

63 *Id*. (quoting the WO Director).

64 SB/SE response to TAS information request (July 31, 2015); LB&I response to TAS information request (July 29, 2015); TE/GE response to TAS information request (Aug. 5, 2015). The GAO has recommended that the IRS "[d]evelop guidance for examiners in operating divisions to use in determining whether an Internal Revenue Code section 6103(n) contract with a whistleblower would be beneficial and outline the steps for requesting such a contract." *See* GAO, GAO-16-20, *IRS Whistleblower Program Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* 46 (Oct. 2015).

65 Andrew Velarde, *Whistleblower Status Letters Seen as a Good Start but Not Enough* 2015 TNT 53-5 (Mar. 19, 2015) (reporting that according to the WO Director, "as a practical matter, investigative disclosures under section 6103(k)(6) can be and have been used to interact with whistleblowers, and auditors are confident in using that authority, which 'works a little easier' and serves as a fair substitute" for IRC § 6103(n) contracts). For a detailed discussion of disclosures under IRC § 6103(k)(6) to third parties other than whistleblowers, where it is *presumed* that the contact with the third party will be disclosed to the taxpayer, see Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*, *supra*. In contrast, as discussed above, IRS procedures require that it not disclose a whistleblower's identity to the affected taxpayer.

66 Treas. Reg. § 301.6103(k)(6)-1(c)(1) provides that these disclosures "may not be made indiscriminately or solely for the benefit of the recipient or as part of a negotiated *quid pro quo* arrangement." The National Taxpayer Advocate does not view providing status updates pursuant to a confidentiality agreement as contravening this requirement.

whistleblower award could be paid, and notifies the whistleblower of a preliminary, or proposed, award.[67] The preliminary award the IRS communicates to the whistleblower includes "a summary report that states a preliminary computation of the amount of collected proceeds, the recommended award percentage, the recommended award amount… and a list of the factors that contributed to the recommended award percentage."[68]

Although the Internal Revenue Manual (IRM) initially treated the administrative process as beginning on the date the WO received the claim for award, Treasury regulations now provide that sending the preliminary award marks the beginning of an "administrative proceeding."[69] Pursuant to IRC § 6103(h)(4), the IRS may disclose returns and return information during a whistleblower administrative proceeding.[70] The regulations under IRC § 7623 require the whistleblower to execute a confidentiality agreement before the IRS will share any information beyond that already provided in the preliminary award.[71] Violating the confidentiality agreement, including by re-disclosing return information, is a negative factor the IRS takes into account in calculating the amount of the award.[72] Noting that "[a]s a practical matter, this factor would be ineffective after payment," the National Taxpayer Advocate recommended that taxpayers be allowed to recover damages for subsequent unauthorized disclosure by whistleblowers.[73] The WO has raised the same concern, noting "current law does not provide an effective sanction if the whistleblower discloses taxpayer information in violation of the confidentiality agreement and section 6103(h)."[74]

More Robust Sanctions for Re-Disclosure of Taxpayer Information by Whistleblowers and Less Restrictive Interpretations of IRC §§ 7623 and 6103 Would Better Protect Taxpayers While Allowing Status Updates to Whistleblowers

The regulatory provision that a whistleblower "administrative proceeding" (which triggers an exception to the disclosure rules) begins only when the IRS proposes an award is an obvious impediment to effective communication with whistleblowers while the case is unfolding and wending its way through various phases that lead to an award. In response to a request for comment on proposed regulations under IRC § 7623, "[s]everal commenters suggested that whistleblower administrative proceedings should begin earlier. The commenters offered different suggestions for how this could be accomplished, including

67 IRC § 6103(h)(4), discussed below.

68 Treas. Reg. § 301.7623–3(c)(2)(ii) (for preliminary awards under IRC § 7623(b)). *See* Treas. Reg. § 301.7623-3(b)(1) (for a similar provision for preliminary awards under IRC § 7623(a)).

69 *Compare* IRM 25.2.2.8, *Whistleblower Award Determination Administrative Proceeding - 7623(a) Claims* (June 18, 2010), *with* Treas. Reg. § 301.7623–3(b) and (c). In practice, the IRS has never treated the administrative proceeding as beginning with receipt of the claim for award from the whistleblower. WO response to TAS information request (Oct. 20, 2015). Issuance of a preliminary denial letter or preliminary rejection letter in IRC § 7623(b) cases also marks the beginning of a whistleblower administrative proceeding. *See* Treas. Reg. § 301.7623-3(c)(7) and (8). (The WO does not conduct whistleblower administrative proceedings for claims rejected or denied under IRC § 7623(a). *See* Treas. Reg. § 301.7623-3(b)(3).)

70 Treas. Reg. § 301.7623–3(a); Treas. Reg. § 301.6103(h)(4)-1.

71 Treas. Reg. § 301.7623-3(c)(3)(iii),(c)(4). Requiring a whistleblower to execute a confidentiality agreement before disclosing taxpayer information pursuant to IRC § 6103(h)(4) is intended to "balance whistleblowers' desire for increased communication with protections and safeguards for taxpayers' confidential information," in view of the lack of any prohibition on re-disclosure of taxpayer information in IRC § 6103(h)(4). *Preamble*, T.D. 9687, 79 Fed. Reg. 47246, 47258 (Aug. 12, 2014).

72 Treas. Reg. § 301.7623-4(b)(2)(vi).

73 National Taxpayer Advocate 2010 Annual Report to Congress 396-97 Legislative Recommendation: *Protect Taxpayer Privacy in Whistleblower Cases*, discussed below.

74 IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* at 6.

beginning whistleblower administrative proceedings at the time that a claim is submitted on the Form 211."[75] However,

> [a]fter considering the comments received, Treasury and the IRS determined that beginning the administrative proceeding before the preliminary award determination letter would not meaningfully increase a whistleblower's ability to participate in and provide comments relating to the award determination. As discussed earlier in this preamble, the IRS will use several tools, including debriefings, section 6103(n) contracts, and section 6103(k)(6) disclosures to communicate with whistleblowers following the submission of a claim.[76]

Implicit in the response is the IRS's position that once a whistleblower submits a claim, further communication with the whistleblower is appropriate only after the IRS determines to make an award (unless the IRS needs information from the whistleblower in the meantime). In view of the lengthy timeframes involved, this approach seems inconsistent with the IRS's announced support for the whistleblower program and its commitment to finding ways of improving communication with whistleblowers.[77]

Neither IRC § 6103 nor any other statute impedes the IRS and Treasury from defining a whistleblower "administrative proceeding" as beginning with the filing of Form 211, and the IRS and Treasury could revise the regulations under IRC § 7623 to allow annual or bi-annual notifications to whistleblowers with basic information, such as whether the claim resulted in an audit, whether an audit has been concluded, whether proceeds from the audit have been collected, and an estimated time within which the WO expects to send a preliminary award. This would allow the WO to retain significant discretion about what it will disclose and how early. As the WO develops procedures for making periodic updates, the IRS and Treasury could update the applicable regulations to define what and when the WO will disclose. However, these changes should not be adopted unless the appropriate regulations (whether under IRC § 6103 or IRC § 7623) are also revised to require whistleblowers who wish to receive status updates to execute confidentiality agreements that carry the statutory penalties imposed by IRC §§ 7431, 7213, and 7213A, and subject them to the safeguarding requirements of IRC § 6103(p).[78]

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75 *Preamble*, T.D. 9687, 79 Fed. Reg. 47246, 47256 (Aug. 12, 2014).

76 *Id*. The IRS may meet with a whistleblower as part of a "debriefing," but the purpose of these meetings "is to help us understand what you know," rather than to disclose information to the whistleblower. IRM 25.2.2-1, *Debriefing Checksheet* (Aug. 7, 2015).

77 *See, e.g.*, William Hoffman, *Tax Analysts Interview with John Koskinen* (Oct. 17, 2014) (reiterating his support for the whistleblower program generally, expressing his willingness to explore ways to improve communication with whistleblowers, and noting the need for anti-retaliation legislation).

78 Because IRC § 7623(b)(6)(A) provides that "[n]o contract with the Internal Revenue Service is necessary for any individual to receive an award under this subsection," the requirement that a whistleblower execute a confidentiality agreement would arise if the whistleblower requests status updates, not necessarily in every case. The National Taxpayer Advocate recommends legislative adjustments that would provide an independent statutory basis for imposing the same liability on whistleblowers whether or not a confidentiality agreement is in place. *See* Legislative Recommendation: *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)*, *infra*.

Tax Court Rules Protect Taxpayer Information and Whistleblower Identity in Court Filings, But Legislation Is Needed to Protect Taxpayers From Re-Disclosure of Their Confidential Information by Whistleblowers and to Protect Whistleblowers From Retaliation in the Event Their Identity Becomes Known

If a challenge to the proposed award under IRC § 7623(b) is not resolved administratively, the whistleblower may petition the Tax Court for review of the award.[79] Disclosure of relevant return information in a judicial tax proceeding is allowed pursuant to IRC § 6103(h)(4) (the same exception that allows disclosure in "administrative proceedings") and disclosures made in open court are generally in the public domain.[80] Unlike whistleblower cases brought pursuant to other statutes, such as the FCA, in which the alleged wrongdoer is a party to the case, in a tax whistleblower case the alleged wrongdoer (the taxpayer) is not a party and may be unaware the case even exists. As the National Taxpayer Advocate has noted:

> A taxpayer's privacy interest generally should not be compromised without consent, which is implicit in civil litigation initiated to contest a tax deficiency or obtain a refund, but not in whistleblower litigation. In the criminal context, considerable procedural protections leading up to a criminal charge and trial that discloses return information, coupled with the significant public interest in obedience to criminal laws, take the place of taxpayer consent.[81]

In 2010, the National Taxpayer Advocate recommended that Congress:

- Require the redaction of third-party return information in administrative and judicial proceedings relating to whistleblower claims;
- Notify a taxpayer of the intent to disclose confidential information and allow the taxpayer to request further redactions before disclosure; and
- Allow taxpayers to recover damages for subsequent unauthorized disclosure by whistleblowers.[82]

In 2012, the Tax Court adopted Rule 345, *Privacy Protections for Filings in Whistleblower Actions*, which:

- Allows a petitioner in a whistleblower case to proceed anonymously; and
- Requires a party or nonparty making the filing to refrain from including, or to redact, the name, address, and other identifying information of the taxpayer to whom the claim relates.[83]

The Tax Court, in its explanation for the proposed change relating to whistleblower cases, noted and discussed the National Taxpayer Advocate's concerns in detail.[84]

These changes in Tax Court rules, while they offer protection to both taxpayers and whistleblowers with respect to documents filed with the court, do not impede a whistleblower from re-disclosing taxpayer

79 IRC § 7623(b)(4), providing Tax Court jurisdiction to review any determination regarding an award under IRC § 7623(b). The Tax Court's review is limited to the WO's determination; "section 7623 [does not] confer authority to direct the Commissioner to commence an administrative or judicial action." *Cohen v. Comm'r*, 139 T.C. 299, 302 (2012).

80 *See Lampert v. U.S.*, 854 F.2d 335, 337 (9th Cir. 1988) (stating "once return information is disclosed in court, such information is no longer confidential, the taxpayer loses any privacy interests in that information") *cert. den'd* 490 U.S. 1034 (1989).

81 Even in a criminal trial, a taxpayer as a party could make a motion to protect private information. *See* Fed. R. Crim. Proc. 49.1. In a whistleblower case, unlike in a criminal or civil tax case, the taxpayer whose return information is disclosed is a third party. National Taxpayer Advocate 2010 Annual Report to Congress 396, 398 (Legislative Recommendation: *Protect Taxpayer Privacy in Whistleblower Cases*).

82 National Taxpayer Advocate 2010 Annual Report to Congress 396 (Legislative Recommendation: *Protect Taxpayer Privacy in Whistleblower Cases*).

83 *See* Tax Ct. R. 345 (effective July 6, 2012). The rule also cross references Rules 27 and 103(a), pertaining to privacy protections and protective orders.

84 *See* United States Tax Court, Press Release (Dec. 28, 2011), *available at* www.ustaxcourt.gov/press/122811.pdf.

information acquired during the whistleblower administrative proceeding or through discovery in the Tax Court proceeding, in a different venue or medium.[85] However, the Tax Court has been proactive in responding to this risk. In *Whistleblower One 10683-13W v. Comm'r*, the Tax Court granted whistleblowers' motions to compel discovery of information in the IRS's hands that should be included in an administrative record, and also ordered:[86]

- The IRS to mark it as "CONFIDENTIAL—Section 6103 Information Subject to Protective Order" any confidential taxpayer information it provides to the whistleblowers;
- "Any person receiving confidential information" to use it "solely for the *bona fide* purpose of conducting this litigation and not for any other purpose whatsoever," on pain of exposure to "sanctions and punishment in the nature of contempt;"
- Whistleblowers and their counsel to not disclose any confidential information directly or indirectly to any person "except for the sole purpose of trial preparation and in accordance with the provisions of the protective order;"
- Whistleblowers and their counsel, when providing confidential information to other persons for trial preparation, "to provide a copy of this order to the person receiving confidential information and inform the person that he or she must comply with the terms of the order. Before providing confidential information, petitioners and their counsel shall obtain the person's signature on a copy of the order, followed by a business or home address of that person at which service of process can generally be made during business hours. Petitioners and their counsel shall retain the signed copy of the order until one year after the decision in this case becomes final;" and
- Whistleblowers, their counsel, "and any other persons who receive confidential information" to "return all copies of any confidential information to respondent or certify in writing to respondent the destruction of all confidential information" upon final resolution of the case.[87]

Imposing meaningful statutory penalties on whistleblowers who engage in such unauthorized re-disclosure would also help protect taxpayers' *right to confidentiality*.[88] In the meantime, the WO could mitigate this risk by requiring whistleblowers who seek status updates to execute confidentiality agreements that would impose safekeeping requirements on whistleblowers and grant affected taxpayers a remedy for unauthorized re-disclosure of their confidential information.[89]

As for whistleblowers, even proceeding in court anonymously does not guarantee that their identity will not come to light or be inferred, at least by some interested members of the public, including their

85 The WO has also voiced concern about this potential for disclosure of taxpayer information. *See* IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* 6-7. At least two whistleblowers shared with the media confidential taxpayer information they acquired pursuant to informal discovery during Tax Court litigation. *See* Jesse Drucker and Peter S. Green, *IRS Resists Whistle-Blowers Despite Wide U.S. Tax Gap* Bloomberg Business (June 19, 2012). Chief Counsel response to TAS information request (Aug. 6, 2015).

86 *Whistleblower One 10683-13W v. Comm'r*, 145 T.C. No. 8 and Order in docket no. 10683-13W (Sept. 16, 2015).

87 *Id*.

88 *See* Legislative Recommendation: *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)*, *infra*.

89 For litigated claims, IRS Chief Counsel attorneys could also seek to protect taxpayer information a whistleblower acquires during discovery or any other phase of the litigation. Tax Court Rule 103, *Protective Orders*, provides in paragraph (a): "Upon motion by a party or any other affected person, and for good cause shown, the Court may make any order which justice requires to protect a party or other person from annoyance, embarrassment, oppression, or undue burden or expense, including but not limited to one or more of the following:… (7) That a trade secret or other information not be disclosed or be disclosed only in a designated way."

employers. As noted above, unlike whistleblowers who proceed under the False Claims Act, tax whistleblowers do not enjoy statutory protection from retaliation. The National Taxpayer Advocate believes IRC provisions are needed to protect tax whistleblowers from retaliation.[90]

CONCLUSION

With its 2006 amendments to the IRC, Congress intended to encourage tax whistleblowing as an efficient means of enforcing the tax laws. The IRS paid only 11 awards under IRC § 7623(b) in the nine years since those amendments and has interpreted statutory provisions protecting taxpayer privacy in ways that prevent it from communicating effectively with whistleblowers who offer to assist the government in recovering unpaid taxes. The IRS relies on exceptions to the same nondisclosure rules in ways that do not adequately protect taxpayers' confidential information from re-disclosure by whistleblowers. Regulatory provisions crafted by the IRS and Treasury reflect these interpretations and should be adjusted to better protect taxpayers and meet the needs of whistleblowers.[91]

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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 Form 211.
2. Revise the regulations under IRC § 6103 or IRC § 7623 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 proceeding, and that the IRC § 6103(p) safeguarding requirements also apply to such a whistleblower.
3. Revise the regulations under IRC § 7623 to require the IRS, upon the whistleblower's execution of a confidentiality agreement as part of an administrative proceeding under IRC § 6103(h)(4), to provide bi-annual status updates sufficient to allow a whistleblower to monitor the progress of the claim (*e.g.*, whether the claim resulted in an audit, whether the audit has concluded, the existence of any collected proceeds, and whether the case has been suspended) according to procedures developed by the WO.

90 See Legislative Recommendation: *Whistleblower Program: Enact Anti-Retaliation Legislation to Protect Tax Whistleblowers*, *infra*.

91 Legislative action is also necessary. See Legislative Recommendation: *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)*; Legislative Recommendation: *Whistleblower Program: Enact Anti-Retaliation Legislation to Protect Tax Whistleblowers*, *infra*.

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

RESPONSIBLE OFFICIALS

Carolyn A. Tavenner, Director, Affordable Care Act Office
Karen Schiller, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED[1]

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

PROBLEM STATEMENT

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.[2] For tax years 2015 and beyond, certain provisions of the ACA impacting employers become effective.[3] For example, applicable large employers (ALEs) must offer minimum essential coverage (MEC) to their full-time employees.[4] Employers not in compliance with this provision may be subject to an assessable payment, referred to as the "employer shared responsibility payment" (ESRP). The IRS expects to receive 77 million new information returns once the business portions of the ACA become effective in 2015.[5]

The ACA also provides for a temporary small business health care tax credit (SBHCTC) designed to defray the costs of employers with 25 or fewer employees whose average annual wage is less than $50,000.[6] Although many businesses will not meet the strict (and complex) criteria for claiming the SBHCTC, the IRS could do more to actively promote this credit to ensure that all eligible employers can take advantage of this subsidy.

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. Through representation on the IRS ACA Executive Steering Committee and several joint

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 *See* Patient Protection and Affordable Care Act of 2009, Pub. L. 111-148, 124 Stat. 119 (Mar. 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

3 For a discussion of concerns expressed by the National Taxpayer Advocate regarding the IRS's implementation of the components of the ACA that impact individual taxpayers, see Most Serious Problem: *Affordable Care Act (ACA) - Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions, infra*. *See also* National Taxpayer Advocate FY 2016 Objectives Report to Congress 38 (Area of Focus: *The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen*); National Taxpayer Advocate 2014 Annual Report to Congress 67 (Most Serious Problem: *Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers*).

4 *See* Internal Revenue Code (IRC) § 4980H.

5 IRS response to TAS information request (Oct. 22, 2015).

6 *See* IRC § 45R(d); Treas. Reg. § 1.45R-2; IRS Notice 2010-44, *available at* www.irs.gov/pub/irs-drop/n-10-44.pdf.

implementation teams, the National Taxpayer Advocate and TAS have identified the following concerns with the implementation of ACA provisions that impact employers:

- Employees in the newly-established ACA Business Exam unit need to receive specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as ALE, MEC, and ESRP;
- The IRS should provide additional guidance to employers on how to calculate the number of full-time equivalents (FTEs) for purposes of meeting MEC requirements;
- The IRS lacks adequate testing of the accuracy of information-reporting data that would verify employer information before the filing season. This could lead to significant taxpayer burden that would subject employers to an unwarranted ESRP or require them to respond to unnecessary notices; and
- The IRS needs to increase active promotion of the availability of the SBHCTC to eligible employers.

Notwithstanding these concerns, we acknowledge the tremendous efforts made by the IRS to implement the health care provisions given their interdependency on decisions made by other federal agencies. Nonetheless, the IRS will be heavily scrutinized by individuals and employers for any ACA-related problems that arise in the context of return filing.

ANALYSIS OF THE PROBLEM

Background

Applicable Large Employers

Internal Revenue Code (IRC) § 4980H(a)(1) provides that an ALE must offer MEC to its full-time employees. In general, an employer is considered an ALE if it employs 50 or more full-time workers (or FTEs), or a combination of full-time and part-time employees that equals at least 50 FTEs.[7]

An employer calculates its FTEs based on each employee's hours of service. For purposes of the ESRP, an employee is considered full-time for a calendar month if he or she averages at least 30 hours of service per week. Under the final regulations, for purposes of determining full-time employee status, 130 hours of service in a calendar month is treated as the monthly equivalent of at least 30 hours of service per week.[8]

IRC § 4980H includes a provision stating that companies with a common owner (or that are otherwise related) generally are combined and treated as a single employer and therefore would be combined for purposes of determining whether or not they collectively employ at least 50 FTEs. If the combined total meets the threshold, then each separate company is subject to the ESRP, including those companies that individually do not employ enough employees to meet the 50 FTEs threshold.

Employer Shared Responsibility Payment

IRC § 4980H provides that ALEs will be subject to an ESRP if (1) it fails to offer its full-time employees the opportunity to enroll in MEC under an eligible employer-sponsored plan, and (2) a Premium Tax

7 IRC § 4980H(c)(2).

8 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

The National Taxpayer Advocate is concerned that the IRS has not yet firmed up its approach to selecting and working cases involving Affordable Care Act (ACA) business issues, even as the 2016 filing season is rapidly approaching.

Credit was paid to at least one full-time employee. The amount of the ESRP under IRC § 4980H(a) is $2,000 per full-time employee per year (determined on a monthly basis).[9]

IRC § 4980H(b) requires ALEs to offer affordable MEC that provides minimum value. If an ALE offers MEC but it is not considered affordable, it will be assessed an ESRP of $3,000 for each employee (determined on a monthly basis) that purchases health insurance from the exchange and is granted a tax credit and/or subsidy for health insurance.[10] While an employer may be subject to ESRP under both IRC § 4980H(a) and (b), the liability is limited to the amount under IRC § 4980H(a).[11]

The ESRP provisions generally are not effective until January 1, 2015, meaning that the ESRP will be first assessed during the 2016 filing season.[12] However, employers must take action during 2015 to avoid liability for ESRP assessed in 2016.

Minimum Essential Coverage, Minimum Value, and Affordability

MEC, minimum value, and affordability are defined under IRC provisions other than IRC § 4980H but all relate to the determination of ESRP. MEC is defined in IRC § 5000A(f) and the regulations under that section and includes employer-provided health care coverage but not coverage providing only limited benefits, such as coverage only for vision or dental care. IRC § 36B(c)(2)(C)(ii) provides the definition of minimum value. An employer-sponsored health plan meets this standard if it is designed to pay at least 60 percent of the total cost of medical services for a standard population.

If an employee's share of the premium for employer-provided coverage would cost the employee more than 9.5 percent of that employee's annual household income (HHI), the coverage is not considered "affordable" for that employee.[13] Because employers generally will not know their employees' HHI, employers can take advantage of several affordability safe harbors set forth in the final regulations that are based on information the employer will have available.[14] If an employer meets the requirements of any of these safe harbors, the offer of coverage will be deemed affordable for purposes of the ESRP provisions regardless of whether it was actually affordable to the employee.

IRC § 4980D Excise Tax

IRC § 4980D imposes an excise tax on employers who maintain a group health plan that fails to meet certain requirements. There is concern that certain flexible spending accounts, health reimbursement arrangements, and other arrangements that reimburse employee premiums for medical insurance purchased on the individual market are considered group health plans subject to the excise tax imposed by IRC § 4980D. By their nature, these arrangements fail to comply with the ACA market reforms that prohibit annual and lifetime dollar limits (Public Health Service Act § 2711) and require plans to provide cost-free

9 IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5).

10 IRS § 4980H(b)(1).

11 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

12 IRS Notice 2013-45, *available at* www.irs.gov/irb/2013-31_IRB/ar08.html.

13 IRC § 36B(c)(2)(B) and (C).

14 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

preventive services (Public Health Service Act § 2713). As a result, it appears that such programs are subject to an excise tax of $100 per affected individual, per day, under IRC § 4980D as plans that fail to satisfy ACA market reforms.[15]

On February 18, 2015, the IRS issued Notice 2015-17[16] providing temporary relief from the IRC § 4980D excise tax for employer programs that reimburse employees for the cost of health insurance coverage purchased individually (including coverage obtained through an Exchange). This excise tax will not be asserted for employers that are not ALEs for 2014 and for January through June 2015. After June 30, 2015, such employers may be liable for the IRC § 4980D excise tax. Understandably, this temporary relief is not all that comforting to small businesses that must decide whether to keep providing such a benefit to their employees at the risk of being assessed an excise tax of $100 per day per employee.

Small Business Health Care Tax Credit

Under IRC § 45R, eligible small employers can claim the SBHCTC for 2010 through 2013 and for two additional years beginning in 2014. A small employer is eligible for the credit if (a) it has fewer than 25 FTE employees, (b) the average annual wages of its employees are less than $50,000 (adjusted for inflation beginning in 2014), and (c) it pays a uniform percentage for all employees equal to at least 50 percent of the premium cost of employee-only insurance coverage.

For 2010 through 2013, the maximum credit was 35 percent of premiums paid by eligible small businesses and 25 percent of premiums paid by eligible tax-exempt organizations. For 2014 and 2015, the maximum credit rate rises to 50 percent for small businesses and 35 percent for tax-exempt organizations.[17] Businesses that have already filed and later find that they qualified in 2013 or an earlier year can still claim the credit by filing an amended return for the affected years.

IRS Employees Need to Receive Training on the Parts of ACA Implementation That Impact Businesses, Including Training on Concepts Such as ALE, MEC, and ESRP

The IRS must ensure that employees who work ACA-related issues, especially those in taxpayer-facing roles, are properly trained on the aspects of the ACA that impact business taxpayers. The IRS has designated that ESRP cases will be worked by a specialized unit out of the Ogden Service Center but does not yet know the grade or series of the examination employees selected to work these ESRP cases.[18] 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 National Taxpayer Advocate is concerned that 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.

Although the IRS developed and delivered a substantial amount of training in advance of the 2015 filing season, much of that training was focused on the components of the ACA that impacted individual taxpayers.[19] In 2015, the IRS expanded training to revenue agents, tax compliance officers, and technical advisors on IRC §§ 4980H, 6055, and 6056. Once the IRS has determined which group of employees

15 *See* IRS Notice 2013-54, *available at* www.irs.gov/pub/irs-drop/n-13-54.pdf.

16 *Available at* www.irs.gov/pub/irs-drop/n-15-17.pdf.

17 *See* Treas. Reg. § 1.45R, 79 FR 36640 (June 30, 2014), *available at* www.federalregister.gov/articles/2014/06/30/2014-15262/tax-credit-for-employee-health-insurance-expenses-of-small-employers.

18 IRS response to TAS information request (Oct. 22, 2015).

19 *See* National Taxpayer Advocate 2014 Annual Report to Congress 71.

will focus on examining employers' compliance with the business aspects of the ACA, this new group of employees will require comprehensive and specialized training.[20]

The IRS Should Provide Formal Guidance to Employers on the Calculation of FTEs for Purposes of Meeting MEC Requirements

IRS outreach and education should continue to focus on increasing awareness to employers of the ACA requirements that are effective beginning in tax year (TY) 2015. For example, the IRS Information Reporting Advisory Committee (IRPAC) reported that the ACA Information Center for Tax Professionals web page on the IRS website should be improved to provide clearer guidance for TY 2014 about what constitutes MEC.[21]

Employers not in compliance with the provisions under IRC § 4980H may be subject to an assessable payment, referred to as the ESRP. On February 12, 2014, the IRS and Treasury issued final regulations on the ESRP provisions.[22] The guidance acknowledges that there are certain categories of employees whose hours of service will be particularly challenging to identify and track and advises their employers to use "a reasonable method of crediting hours of service that is consistent with section 4980H." The preamble provides some examples of what may be considered a reasonable method in certain industries but is far from comprehensive.

In addition to the final regulations, the IRS provides clarification of the guidance in the form of an ESRP Q&A page and an ALE Information Center on irs.gov.[23] While they contain helpful information, the limited Q&A page and ALE Information Center do not adequately address many questions about the calculation of FTEs for purposes of meeting the MEC requirements. Q&As are helpful, but they do not have the impact of formal guidance, which undergoes a notice and comment period. Furthermore, although informal guidance is better than no guidance, taxpayers may not rely on Q&As found on the IRS website for penalty defense purposes.

The Inability of the IRS to Adequately Test the Accuracy of Information-Reporting Data Before the Filing Season Can Inhibit IRS Verification Efforts and May Cause Significant Taxpayer Burden

The IRS relies on information reports to verify data relevant to the ESRP liability and SBHCTC eligibility. Beginning in the 2016 filing season, the IRS will receive and process an estimated 77 million new information returns from employers.[24]

IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. IRC § 6056 requires annual information reporting by ALEs relating to the health insurance that the employer offers (or does not offer) to

20 The IRS did not provide specific course modules or training schedules for business-related ACA issues. *See* IRS response to TAS information request (Oct. 27, 2015).

21 *See* IRS, *2014 IRPAC Public Report: Employee Benefits and Payroll Subgroup*, *available at* www.irs.gov/Tax-Professionals/IRPAC-Public-Report-Employee-Benefits-and-Payroll-Subgroup-2014.

22 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

23 *See* IRS, *Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act*, *available at* www.irs.gov/Affordable-Care-Act/Employers/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act (last visited Dec. 1, 2015); IRS, *ACA Information Center for Applicable Large Employers (ALEs)*, *available at* www.irs.gov/Affordable-Care-Act/Employers/ACA-Information-Center-for-Applicable-Large-Employers-ALEs (last visited Dec. 1, 2015).

24 IRS response to TAS information request (Oct. 22, 2015).

its full-time employees. Below is a list of information returns the IRS created to meet these reporting requirements:

- Form 1095-B, *Health Coverage* (used by health insurance issuers and carriers to report information about individuals who are covered by MEC and therefore aren't liable for the individual shared responsibility payment; due by February 28 (or March 31 if filing electronically));[25]
- Form 1094-B, *Transmittal of Health Coverage* (used by health insurance issuers and carriers to submit Form 1095-B);
- Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage Insurance* (furnished by ALEs to any full-time employee for one or more months of the year; due by February 28 (or March 31 if filing electronically));[26] and
- Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns* (used by ALEs to submit Form 1095-C).

FIGURE 1.14.1, Projected Volume of Information Returns for ACA Exchange Provisions, Tax Years 2015–2017[27]

	Tax Year 2015	Tax Year 2016	Tax Year 2017
Forms 1095-B	46 million	45 million	47 million
Forms 1095-C	77 million	77 million	78 million
Total	**123 million**	**122 million**	**125 million**

As noted above, the IRS expects to receive over 120 million information returns from health insurance providers and ALEs during the 2016 filing season. If this information is not furnished to the IRS timely, the IRS has little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers. As of the time of publication, the IRS has not been able to fully test the ability of its information technology systems to handle the expected volume of ACA information returns. Furthermore, the IRS has not expanded the taxpayer identification number (TIN) matching program to health insurers and self-insured employers that are required to file Form 1095-B, which may lead to mismatches and unnecessary notices.[28]

If the IRS receives incomplete or inaccurate data, taxpayers will be harmed.[29] For example, if the IRS cannot accurately verify coverage information, it will inhibit the IRS's ability to verify eligibility for the SBHCTC. Furthermore, ALEs may unnecessarily be required to substantiate coverage to employees if the data is unreliable and contains false positives. If the IRS receives inaccurate data regarding coverage, it may erroneously assess ESRPs on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify.

25 IRS, *Instructions for Forms 1094-B and 1095-B* (2015), *available at* www.irs.gov/pub/irs-pdf/i109495b.pdf.

26 IRS, *Instructions for Forms 1094-C and* 1095-C (2015), *available at* www.irs.gov/pub/irs-pdf/i109495c.pdf.

27 IRS response to TAS information request (Oct. 22, 2015).

28 *See* Most Serious Problem: Affordable Care Act (ACA) - Individuals: *The IRS Is Compromising Taxpayers Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *infra*.

29 *See* National Taxpayer Advocate 2014 Annual Report to Congress 75-6 (discussing TIN matching for Form 1095-B; the IRS will use Form 1095-B to verify compliance with IRC § 5000A); Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*, *infra*.

The IRS Should More Actively Promote the Availability of the SBHCTC to Eligible Employers

To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC.[30] This tool allows small businesses to estimate their credits (if any) and find out how any changes in circumstances will impact their eligibility. Since November 2012, the SBHCTC estimator has been available on the TAS Tax Toolkit,[31] where small businesses and tax professionals can access it easily, and TAS has continually promoted it through social media, including Twitter and Facebook.

Notwithstanding the efforts of TAS, the IRS should do more to promote the availability of the SBHCTC to eligible employers. Yet it is difficult for the IRS to actively promote this credit to small businesses when it has decimated its public outreach staff, such that as of the end of October 2015, 14 states (plus the District of Columbia) did not have a single outreach and education employee dedicated to small businesses located within their borders.[32]

The IRS expects to receive over 120 million information returns from health insurance providers and Applicable Large Employers (ALEs) during the 2016 filing season. If this information is not furnished to the IRS timely, the IRS has little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers.

CONCLUSION

The 2016 filing season will be challenging as the IRS implements several ACA provisions that impact employers against the backdrop of historically low levels of taxpayer service. Although the IRS developed systems and procedures to administer components of the ACA impacting individual taxpayers in the 2015 filing season, the IRS will face new challenges in the 2016 filing season when business taxpayers file their TY 2015 returns and report ESRP liabilities. The IRS will receive and process a significant amount of new information returns from insurers and exchanges to identify errors and noncompliance. While the IRS has little control over some of the anticipated risks, such as delayed or inaccurate data reporting from the exchanges, it will be held publicly responsible when the associated problems surface during the tax return filing process.

Because of the increased risk of taxpayer harm this filing season, TAS will continue to address issues as they arise and identify systemic problems. TAS will continue to assign ACA Rapid Response team members to immediately address any potential ACA systemic issues that arise during the 2016 filing season. In addition, we encourage both internal and external stakeholders to report any suspected ACA systemic issues on TAS's Systemic Advocacy Management System.[33]

30 To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC, *available at* www.taxpayeradvocate.irs.gov/estimator/smallbusiness2014/.

31 The TAS Tax Toolkit is a website that contains useful tax information for individuals, businesses, tax professionals and media, including news and updates, ways TAS helps taxpayers, and important information about tax topics and rights and is available at http://www.TaxpayerAdvocate.irs.gov.

32 IRS Human Resources Reporting Center, *Report of SB/SE Job Series, Stakeholder Liaison Field Employees as of October 31, 2015* (Nov. 10, 2015). The 14 states are Alaska, Delaware, Hawaii, Iowa, Kentucky, Mississippi, Montana, Nebraska, New Hampshire, North Dakota, South Dakota, Vermont, West Virginia, and Wyoming. *See also* National Taxpayer Advocate 2014 Annual Report to Congress 31 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

33 Stakeholders can report suspected systemic issues at www.irs.gov/sams.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Provide additional guidance to employers and tax practitioners on how to calculate the number of FTEs for purposes of meeting the MEC requirements.
2. Publish regulations explaining how the IRC § 4980D excise tax may apply to certain flexible spending accounts and health reimbursement arrangements.
3. Establish a Rapid Response team to assist front-line IRS employees with issues, problems, or questions from employers or tax practitioners.
4. Provide employees in its newly-established ACA Business Exam unit with comprehensive and specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as ALE, MEC, and ESRP.

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

RESPONSIBLE OFFICIALS

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Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *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 Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*

DEFINITION OF PROBLEM

Overall, the IRS has done a commendable job of implementing the first stages of the Patient Protection and Affordable Care Act of 2010 (ACA), including developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies.[2] The 2015 filing season (FS) presented difficult challenges with the introduction of the Individual Shared Responsibility Payment (ISRP)[3] and the Premium Tax Credit (PTC)[4] on tax year (TY) 2014 federal income tax returns. At the

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 ACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA), Pub. L. No. 111-152, 124 Stat. 1029 (2010).

3 Internal Revenue Code (IRC) § 5000A. Taxpayers filing tax year (TY) 2014 federal income tax returns were required to report they have "minimum essential coverage" (MEC) or were exempt from the responsibility to have the required coverage. If the taxpayer did not have coverage and was not exempt, he or she was required to make a shared responsibility payment (SRP) when filing a return.

4 PTC is a refundable tax credit paid either in advance or at return filing to help taxpayers with low to moderate income purchase health insurance through the exchange. IRC § 36B. The amount of the credit paid in advance is based on projected household income (HHI) and family size for the year of coverage, while the amount for which a taxpayer is actually eligible is based on actual HHI and family size for the year reflected on the tax return. Many taxpayers were required to reconcile the credit amount they received in advance with the PTC to which they were actually entitled. IRC § 36B(f).

same time, the IRS received and processed new information returns from insurers and exchanges.[5] While the IRS performed well overall, several developments will likely result in significant burden imposed on both taxpayers and the IRS in future years:

- Taxpayers who received the advanced premium tax credit (APTC) in 2014 and did not file TY 2014 returns (and the Form 8962, *Premium Tax Credit (PTC)*) by Fall 2015 will face difficulties receiving APTC payments in 2016;
- The pre-refund Automated Questionable Credit (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;[6]
- 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;
- The absence of the Second Lowest Cost Silver Plan (SLCSP) amounts on some Forms 1095-A, *Health Insurance Marketplace Statement*, are delaying the processing of PTC returns and imposing unnecessary burden on taxpayers; and
- 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.

ANALYSIS OF PROBLEM

Background

ACA was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, the ACA provides targeted tax credits for low income individuals and for small businesses, while imposing a personal responsibility on individuals to have health coverage.[7]

Filing Season 2015 Overall Results

Since enactment, the IRS has been implementing complicated ACA provisions that require developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies. The IRS implementation efforts were tested during FS 2015. The IRS achieved a relatively high level of service (LOS) on the ACA telephone hotline (800-919-0452) at about 61 percent for fiscal year (FY) 2015, which far exceeded the 38 percent overall LOS on the Accounts Management (AM) toll-free

5 The Health Insurance Marketplace, also called the "exchange," is a state- or federally-operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or who buy insurance on their own. *See* http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace. IRC § 6055 and the regulations thereunder require every person (*i.e.*, health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage) that provides MEC (as defined in IRC § 5000A(f)) to an individual to report to the IRS information about the coverage of each individual covered under the policy. IRC § 6056 requires annual information reporting by applicable large employers (ALEs) relating to the health insurance that the employer offers (or does not offer) to its full-time employees. Notice 2013-45, 2013–31 I.R.B. 116 (July 29, 2013) and T.D. 9660, 2014-13 I.R.B. 842 provide transition relief by delaying the information reporting required under IRC §§ 6055 and 6056 until 2016 for coverage in 2015, but the IRS has encouraged entities to voluntarily provide information returns for coverage provided in 2014, which was due to be filed and furnished in early 2015.

6 The IRS is prohibited from conducting unnecessary examinations or investigations pursuant to IRC § 7605(b).

7 IRC § 4980H(a)(1) imposes a responsibility for ALEs to offer health care to employees in certain circumstances. ACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by HCERA, Pub. L. No. 111-152, 124 Stat. 1029 (2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).

lines.[8] The IRS received and processed new information returns from employers, insurers, and exchanges. Taxpayers filing TY 2014 federal income tax returns were required to report that they had "minimum essential coverage" (MEC) or were exempt from the responsibility to have the required coverage in 2014. If the taxpayer did not have coverage and was not exempt, he or she was required to make an ISRP when filing the 2014 return.[9] The following figure provides data on the reporting of ISRPs on TY 2014 returns:

FIGURE 1.15.1, Reporting of Individual Shared Responsibility Payments on TY 2014 Returns Through August 27, 2015[10]

Returns claiming coverage	106 million
Returns with ISRP	7.6 million
Average ISRP	$204
Prepared returns reporting ISRP	5.0 million
Forms 8965	12.1 million
Forms 8965 Claiming Household Coverage Exemption	3.65 million
Forms 8965 Claiming Coverage Exemption	8.4 million
Forms 8965 Submitted with Prepared Return	6.5 million

Additionally, eligible individual taxpayers claimed the PTC for the first time on TY 2014 returns filed during FS 2015 filing. If the taxpayers received the credit in advance, they had to reconcile the APTC amount with the amount of the credit to which they were entitled.[11] The following figure provides information regarding the extent to which individual taxpayers claimed the PTC on their TY 2014 returns.

FIGURE 1.15.2, Reporting of the Premium Tax Credit on Forms 8962 for TY 2014 Returns Through August 27, 2015[12]

Forms 8962	3.3 million
Total PTC Claimed	$9.9 billion
Average PTC	$3,011
Returns reporting APTC	3.1 million (93% of total PTC returns)
Total APTC Reported	$11.3 billion
Forms 8962 Submitted with Prepared Returns	2.0 million (61% of total PTC returns)

8 The AM LOS of approximately 38 percent is a combined figure reflecting 30 customer service lines. The higher LOS on the ACA line may be due, at least in part, to the fact that the number of calls to the ACA line was significantly lower than the IRS anticipated. IRS, *FY 2015 President's Budget* 4-5, 19-23. The ACA line received about one million net attempted calls, as compared with over 101 million on the AM lines overall during the period. IRS, Joint Operations Center (JOC), *Product Line Detail (Enterprise Performance)* (week ending Sept. 30, 2015); IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015).

9 IRC § 5000A.

10 Wage & Investment Research and Analysis (WIRA), *ACA Fact Sheet* (Oct. 8, 2015) (returns processed through August 27, 2015, Cycle 34). This data is based on amounts claimed on returns that had posted as of August 27, 2015, and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2014 returns and conducts compliance activities. IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File for TY 2014 (through cycle 201534).

11 IRC § 36B(f). The amount of the credit paid in advance is based on projected income while the amount for which a taxpayer is actually eligible is based on actual income.

12 WIRA, *ACA Fact Sheet* (Oct. 8, 2015) (returns processed approximately Aug. 27, 2015). This data is based on amounts claimed on returns that had posted as of August 27, 2015, and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2014 returns, and conducts compliance activities.

Significant Issues That Arose During Filing Season 2015

As FS 2015 progressed, the IRS ran into the following three significant issues.[13]

A Significant Number of Taxpayers Overstated the ISRP on TY 2014 Returns

Approximately 412,000 taxpayers overstated their ISRP, totaling about $50.6 million through August 27, 2015 (cycle 34).[14] The *average* ISRP overstatement amount was almost $123 per return.[15] These taxpayers did not owe an ISRP for reasons that include:[16]

- The taxpayer was eligible for an ISRP exemption because the reported income is below the income tax filing threshold;[17]
- The taxpayer indicated that he or she could be claimed on another return;[18] and
- Transposition, calculation, or input error.

The IRS decided to issue soft notices to impacted taxpayers. On November 27, 2015, the IRS began issuing approximately 319,000 Letters 5600-C informing taxpayers of the potential overpayment and instructing them to file an amended return and attach Form 8965, *Health Coverage Exemptions*, if applicable. The IRS is exploring the feasibility of systemically adjusting ISRP amounts through programming. If feasible, the IRS would be able to take this action in late Spring 2016.[19] We believe that the IRS should take preventative measures to avoid ISRP overpayments in the future, such as distributing educational notices to preparers associated with overpayments and conducting a comprehensive review and testing of private-sector tax filing software to ensure that problems arising in FS 2015 do not recur.[20]

13 For a detailed discussion of these issues, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 38-47 *(The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen).*

14 WIRA analysis on ISRP overstatements, through cycle 34 (August 27, 2015), on file with TAS Research. The IRS cannot calculate the exact amount of ISRP overpayments until all dependents have filed their TY 2014 tax returns (The amount of the ISRP depends on HHI pursuant to IRC § 5000A(c)).

15 This average only includes returns with an ISRP overstatement.

16 More than 268,000 taxpayers were eligible for an ISRP exemption. These taxpayers paid in over $33 million in ISRP. In addition, more than 50,000 taxpayers paid a total of nearly $12.7 million because the ISRP amount was miscalculated. The remaining nearly 93,000 taxpayers had multiple adjustments to an ISRP, overstatements of $50 or less, or returns under IRS Examination (totaling almost $4.7 million). These amounts include returns processed by the IRS through the end of August 2015. WIRA estimates from the Individual Returns Transaction File on the IRS CDW. This data is preliminary and is subject to change as the IRS reviews the data, processes additional TY 2014 returns, and conducts compliance activities.

17 IRC § 5000A(e)(2).

18 IRC § 5000A(a).

19 W&I response to TAS information request (Oct. 29, 2015); W&I response to TAS fact check (Dec. 14, 2015) (the IRS expected to mail all letters by December 31, 2015).

20 To determine the experience of taxpayers and find out if the Free File programs accurately calculate the ISRP and determine exemption eligibility, TAS created three scenarios and tested them on each of the 14 Free File sites during FS 2015. We found that four programs correctly calculated no ISRP due to an applicable exemption, but never informed the taxpayer whether he or she qualified for the exemption of income amounts that were below the filing threshold. One program did not seem to support IRS Form 8965, *Health Coverage Exemptions*. The program did not provide the appropriate prompts to take the hardship exemption and incorrectly calculated ISRP. Three programs assumed the user already knew about the available exemptions and did not provide sufficient guidance. We reported our findings to the IRS and the IRS coordinated with the Free File Alliance and all software providers associated with any of the above-mentioned problems adjusted their programs to avoid similar errors in the future. For a more detailed discussion of the FS 2015 Free File software issues, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 38-47 (*The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen*).

Exchanges Made Errors on Forms 1095-A, Leading to an IRS Resolution to Reduce Taxpayer Burden

The Centers for Medicare and Medicaid Services (CMS) announced in February 2015 that about 20 percent (or 800,000) of the tax return filers who purchased health insurance from the federal exchange received Forms 1095-A, *Health Insurance Marketplace Statement*, with errors in the SLCSP information.[21] The exchange issued corrected Forms 1095-A. The Department of Treasury publicly stated that the IRS would not pursue collection of any additional taxes or require the taxpayer to file an amended return based on the updated information in the corrected forms if the taxpayer filed a 2014 tax return with the incorrect Form 1095-A amounts.[22] On April 10, 2015, the IRS issued Notice 2015-30, providing penalty relief for incorrect or delayed Forms 1095-A for taxpayers who timely filed their 2014 return.[23]

The IRS identified returns with errors in the SLCSP, but did not issue guidance to all employees on how to distinguish taxpayers impacted by the CMS announcement.[24] We believe the IRS may adjust the PTC on returns filed with an incorrect Form 1095-A and pursue collection since there is no guidance to prevent this from occurring. TAS will be monitoring its own case receipts to see if such collection activity, including refund offsets, is taking place, and will work with the IRS to issue interim guidance.

Approximately 412,000 taxpayers overstated their Individual Shared Responsibility Payment (ISRP) totaling about $50.6 million through August 27, 2015 (cycle 34). The average ISRP overstatement amount was almost $123 per return.

Taxpayers Who Received APTC in 2014 and Did Not File TY 2014 Returns (and Form 8962) by Fall 2015 Will Face Difficulties Receiving APTC in 2016

The Department of Health and Human Services (HHS) regulations that implement the ACA include a process for re-enrolling taxpayers in health insurance and determining their eligibility for the APTC. To determine eligibility, the regulations require the exchange to verify income and family size with the IRS.[25] The IRS has begun to provide a response code during the verification process that signifies that a taxpayer has not filed a tax return reconciling the amount of APTC received.[26] The response code indicates to the Marketplace that a taxpayer may not be eligible to receive the APTC for the new coverage year. It is our understanding that the IRS began to provide such response codes during Marketplace open enrollment for coverage year 2016, which began on

21 The amount of the SLCSP is a factor used to determine the amount of PTC a taxpayer is allowed. The SLCSP is based on such factors as an individual's age and the area in which he lives. IRC § 36B(b)(3)(B).

22 U.S. Department of Treasury, Press Center, *Statement from a Treasury Spokesperson on CMS Announcement Last Week About 1095-A* (Feb. 24, 2015) and *Statement from a Treasury Spokesperson on Forms 1095-A* (Mar. 20, 2015), *available at* http://www.treasury.gov/press-center/press-releases/Pages/jl9981.aspx and http://www.treasury.gov/press-center/press-releases/Pages/jl10005.aspx, respectively. *See also* Treasury Inspector General for Tax Administration, Ref. No. 2015-43-043, *Affordable Care Act: Assessment of Internal Revenue Service Preparation for Processing Premium Tax Credit Claims* 12 (May 11, 2015) (urging the IRS to develop a tool to enable taxpayers to determine the correct SLCSP premium); SERP Alert 15A0147, *Responding to Taxpayer Inquiries about Corrected Forms 1095-A, Health Insurance Marketplace Statements* (Feb. 26, 2015, rev. Apr. 6, 2015).

23 Notice 2015-30, 2015-17 I.R.B. 928 (Apr. 27, 2015). For more information regarding the impact of the incorrect Forms 1095-A as well as the National Taxpayer Advocate's concerns, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 38-47 (*The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen*).

24 IRM 3.12.3.75.9, *Error Code 198, Form 8962, Annual/Monthly SLCSP Amount(s), Column B (ACA)* (Jan. 1, 2015).

25 45 CFR § 155.335, Annual eligibility redetermination; HHS, *Guidance on Annual Eligibility Redeterminations and Re-enrollments for Marketplace Coverage for 2016* (Apr. 22, 2015), *available at* https://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/annual-redeterminations-for-coverage-42215.pdf.

26 In some cases the taxpayer may have filed a tax return but did not attach the Form 8962 which is necessary to reconcile the APTC. IRS ACA Office response to TAS information request (Nov. 5, 2015).

November 1, 2015.[27] For all taxpayers who previously received the APTC and filed their tax returns and Form 8962 by the date of the verification, the exchanges automatically re-enrolled the taxpayers and recalculated their 2016 APTC amount during the fall of 2015. Taxpayers who failed to file a tax return (or who filed and failed to attach Form 8962) by the date of the verification, regardless of whether they had a valid extension of time to file, will be re-enrolled in their insurance for 2016; however, they will not automatically receive the APTC.[28] To receive the APTC, these taxpayers will have to file their 2014 tax return, including a reconciliation on Form 8962, and then go back to the Marketplace for a redetermination of their eligibility for the APTC. This creates extra burden for taxpayers to reestablish their eligibility for the advanced credit. Some taxpayers may erroneously believe their automatic re-enrollment in their insurance plan also includes APTC re-enrollment and not take the steps necessary to receive the APTC in 2016.

The National Taxpayer Advocate is concerned about the burden imposed on taxpayers due to the timing of the verification process between the IRS and the exchanges. Approximately 360,000 taxpayers with APTC filed for an extension for TY 2014 returns, which allows them to file on or before October 15, 2015.[29] It is our understanding that balance due returns take longer to process and a significant portion of these returns may have been impacted by such response codes in the verification process.[30]

Commendably, the IRS sent Letters 5591 or 5591A to APTC recipients who had not filed tax returns but received APTC. The IRS also sent Letter 5596 to APTC recipients who had yet to file a 2014 return but had filed for an extension. The letters urged the recipient to file as soon as possible to avoid a gap in receiving APTC in 2016.[31] The following figure sets forth how many of each type of letter the IRS sent, as well as the dates mailed:

FIGURE 1.15.3, Letters Sent to APTC Recipients Who Had Not Yet Filed Returns[32]

Type of IRS Letter	Count	Dates Mailed
Ltr 5591	567,976	July 10, 2015 to July 30, 2015
Ltr 5591A	149,688	July 31, 2015 to Aug. 21, 2015
Ltr 5596	337,065	Aug. 6, 2015 to Aug. 21, 2015

TAS did not have the opportunity to provide meaningful review of some of the letters prior to final approval by the IRS. We believe that the letters did not adequately warn taxpayers of the need to file returns by a particular date to avoid a cumbersome process to continue receiving APTC in 2016. We advise the IRS to work with the National Taxpayer Advocate on revisions to Letters 5591, 5591A, and 5596

27 IRS ACA Office response to TAS information request (Nov. 5, 2015).

28 HHS *Guidance on Annual Eligibility Redeterminations and Re-enrollments for Marketplace Coverage for 2016* (Apr. 22, 2015), *available at* https://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/annual-redeterminations-for-coverage-42215.pdf. IRS ACA Office response to TAS information request (Nov. 5, 2015).

29 IRS Commissioner John Koskinen Letter to Members of Congress 3 (July 17, 2015), *available at* http://www.irs.gov/pub/irs-utl/CommissionerLetterlwithcharts.pdf.

30 IRM 21.3.12.2, *Balance Due Research* (Oct. 1, 2015). TAS encounters this issue when the taxpayer needs the return posted for purposes of getting tax transcripts for financial aid, loan applications, and proof of income. The payments for some balance due returns are visible on the account, but no associated return has posted. IRM 1.2.3.5.7, *Transcript Restrictions and Special Handling* (Aug. 19, 2015).

31 IRS Letters 5591, 5591A, 5596.

32 W&I response to TAS information request (Oct. 29, 2015).

Despite the fact that the Letter 4800C begins with the language, "This is not an audit. Your return may be examined in the future," we are concerned that the Automated Questionable Credit (AQC) process and the documentation requirements imposed on the taxpayers under AQC are substantially similar to those in an examination.

for FS 2016. The IRS should provide outreach and education early in the filing season to inform taxpayers about the consequences of filing for an extension if they received the APTC, or at least, the risk of waiting until fall to file even with a valid extension.

The Pre-Refund Automated Questionable Credit (AQC) Procedures for PTC Mismatches Impose the Same Burden As a Post-Refund PTC Exam Without the Same Due Process Protections, Thereby Subverting the Statutory Protections Against Multiple Audits of the Same Return

The IRS is generally prohibited by Internal Revenue Code (IRC) § 7605(b) from auditing a return twice.[33] IRC § 7605(b) first appeared as § 1309 of the Revenue Act of 1921.[34] At that time, Congress designed the section in response to taxpayer complaints that revenue agents were subjecting them to onerous and unnecessarily frequent examinations and investigations. The purpose of the section was to relieve taxpayers from unnecessary annoyance.[35] Accordingly, the manner in which the IRS is conducting pre-refund "reviews" of taxpayers' PTC returns raises serious concerns about the IRS subjecting taxpayers to multiple audits and undermining this important protection.

During submission processing, the IRS ACA Verification Service (AVS) matches data reported on PTC returns with data reported from the Marketplace. AVS checks all returns to verify if the taxpayer received APTC and reconciled the advance payment on Form 8962, *Premium Tax Credit (PTC)*. If the data does not match or the APTC was not reconciled on Form 8962, the IRS will delay processing the return and send the taxpayer Letter 12C, requesting a corrected Form 8962, or Form 1095-A, *Health Insurance Marketplace Statement,* to support the credit and reconcile the APTC.[36]

The IRS cannot use math error authority to adjust return discrepancies attributable to third-party data mismatch. In those cases, the IRS places a freeze on the refund, or a portion thereof, and refers the return to Compliance for further treatment.[37]

33 *See* IRC § 7605(b); Rev. Proc. 2005-32, § 4.03, 2005-1 C.B. 1206 (discussing procedures the IRS does not consider examinations). IRC § 7605(b) provides "No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary."

34 Revenue Act of 1921, ch. 136, § 1309, 42 Stat. 310 (1921) (now codified at IRC § 7605(b)).

35 Harold Dubroff and Brant J. Hellwig, United States Tax Court: A Historical Analysis: A Historical Analysis, Government Printing Office fn. 100 (2d. Ed. 2015); *United States. v. Powell*, 379 U.S. 48, 54-55 (1964) (quoting the statement of Senator Penrose, the manager of the bill: "I know that, from many of the cities of the country, very bitter complaints have reached me and have reached the department of unnecessary visits and inquisitions after a thorough examination is supposed to have been had. This section is purely in the interest of quieting all this trouble, and in the interest of the peace of mind of the honest taxpayer.").

36 For FY 2015 the IRS issued 684,332 total ACA-related correspondences. From March 2, 2015, to November 28, 2015, 124,639 returns were suspended for research prior to correspondence for PTC matching issues. Of the suspended returns, 69,019 were resolved via research and 55,620 required correspondence. W&I response to TAS information request (Oct. 29, 2015); W&I response to TAS fact check (Dec. 14, 2015).

37 IRM 21.6.3.4.2.16.3, *At-Filing Overview* (Oct. 1, 2015); IRC § 6213(b). Examples of third-party data mismatch include the following: (1) The taxpayer claims PTC but the taxpayer's household income (HHI) is less than 100 percent of the Federal Poverty Line (FPL) and all tax family members are U.S. citizens; (2) The taxpayer claims PTC but there is no record that anyone claimed on the return was enrolled in a Qualified Health Plan through the Marketplace; (3) Marketplace data is available for all months and the taxpayer's annual premium amount does not equal the annual premium reported by the Marketplace; (4) Marketplace data is available for all months and the taxpayer's annual premium of SLCSP does not equal the annual SLCSP reported by the Marketplace; and (5) Marketplace data is available for all months and the annual APTC reported by the taxpayer does not equal the annual APTC reported by the Marketplace. IRM 25.25.7.8.1, *Premium Tax Credit (PTC) Error Codes (ERC) (associated with AQC)* (Jan. 9, 2015).

Depending on the type of PTC discrepancy, the IRS refers the return either to Examination to work as a traditional audit or to the AQC program for a similar "audit" process.[38] If referred to AQC, the IRS sends a Letter 4800C, *Questionable Credit 30 Day Contact Letter*, which proposes an adjustment and requests Form 1095-A.[39]

Despite the fact that the Letter 4800C begins with the language, "This is not an audit. Your return may be examined in the future," we are concerned that the AQC process and the documentation requirements imposed on the taxpayers under AQC are substantially similar to those in an examination. In AQC, if a Form 1095-A is not verified, the IRS will ask for "documentation proving premium payments, copies of insurance enrollment forms, invoices, or statements from the insurance providers that include the names of those covered by the benefits."[40] An examination of the same issue requires the same documentation on Form 14950, *Premium Tax Credit Verification,* which requests "copies of insurance enrollment forms, invoices, or statements from your insurance providers."[41]

The National Taxpayer Advocate believes that if a taxpayer submits the same information when the return is in AQC as he would in an exam, the AQC constitutes an actual examination of the taxpayer's books and records. When the IRS doesn't classify these tax AQC adjustments as an examination, the IRS does not trigger the taxpayer's right to avoid unnecessary examinations.[42] This position enables the IRS to later conduct an examination of a taxpayer who already has been subjected to an examination of the same return, thereby undercutting an important taxpayer protection enacted by Congress to avoid that very result.

TAS requested an opinion from the Office of Chief Counsel on whether an AQC inquiry into a PTC matching issue constitutes an audit for purposes of IRC § 7605. We received advice in the form of an email which concluded that such AQC inquiries do not constitute an exam for purposes of IRC § 7605(b). The Office of Chief Counsel, Procedure and Administration provided the following advice:[43]

> Revenue Procedure 2005-32 defines a number of taxpayer contacts that are not examinations for purpose of section 7605(b). Among those contacts that do not constitute an examination are matching information on a return with information already in the Service's possession and

38 The AQC program is a type of work stream IRS uses to resolve refundable credit discrepancies that generally do not meet the traditional Examination or AM work stream type. IRM 25.25.7.1, *Automated Questionable Credit (AQC) Overview* (Jan. 9, 2015).

39 If the taxpayer provides an incomplete response to the 4800C, the AQC tax examiner attempts to reach the taxpayer by phone to request additional information. If the examiner is unable to reach the taxpayer by phone, AQC sends Letter 131C, *Information Insufficient or Incomplete for Processing Inquiry*, to request additional documentation in writing. If the taxpayer provides information in response to the Letter 4800C indicating disagreement with the proposed adjustment, but the taxpayer provides documents deemed insufficient or if AQC does not receive a response from the taxpayer, the AQC tax examiner issues a Statutory Notice of Deficiency (SNOD) or Claim Disallowance letter. If there is no response within the notice period, IRS defaults the SNOD and removes the credit from the taxpayer's account. IRM 25.25.7.2, *AQC Inventory Types* (June 1, 2015); IRM 25.25.7.4(8) & (9) (June 8, 2015).

40 IRM 25.25.7.2, *AQC Inventory Types* (June 1, 2015).

41 In FY 2015, the IRS routed 20,147 accounts to AQC for PTC mismatch issues. Of the 20,147 referred to AQC, 8,034 cases were referred to Exam (ERC 197, 198 and 199 determined to need recalculations and Exam treatment) and 6,312 were resolved. The additional 5,801 cases remained open in AQC suspense at the end of FY 2015. The IRS selected 18,810 TY 2014 PTC returns for examination during 2015 (through Sept. 25, 2015). Of the selected cases, Exam closed 2,322 returns, of which 885 were no change; 1,356 were agreed, and 81 were unagreed/default. The 885 no change cases include 462 cases selected incorrectly due to a programming error (figures reflect W&I). W&I response to TAS information request (Oct. 29, 2015); W&I response to TAS fact check (Dec. 14, 2015).

42 IRC § 7605(b).

43 Email from the Office of Chief Counsel (Nov. 13, 2015), on file with TAS.

> considering any records the taxpayer provides voluntarily to explain a discrepancy between a filed return and information from third parties that is used as part of a matching program. Rev. Proc. 2005-32 § 4.03(1)(b) & (c). An example of this kind of contact is "a contact with a taxpayer to… verify a discrepancy between the taxpayer's tax return and an information return, or between a tax return and information otherwise in the Service's possession." *Id.* at 4.03(1)(d)(ii)(C). Here, the Service is contacting a taxpayer to resolve a discrepancy between a taxpayer's Form 1095-A or Forms 1040 and 8962 and the 1095-A, already in the Service's possession, provided by the Health Insurance Marketplace. Such a contact falls squarely within the revenue procedure's definition of a contact that does not constitute an examination.
>
> Even if the Service requests that the taxpayer provide additional documentation, such as proof of premium payments or copies of insurance enrollment forms, this contact should not constitute an examination. Requesting this information is a contact designed to verify a discrepancy between the taxpayer's return and information obtained as part of a matching program. It appears to fall within the example the Revenue Procedure provides of the type of contact that does not constitute an examination. Id. This interpretation of the revenue procedure is amplified by Policy Statement 4-3. That policy statement states, "contact[s] to verify a discrepancy disclosed by an information return matching program may include inspection of the taxpayer's books of account, to the extent necessary to resolve the discrepancy, without being considered an inspection within the meaning of section 7605(b) of the Code." IRM 1.2.13.1.1(5). In this case, the documents the Service is likely to request are only those necessary to resolve the discrepancy. See IRM 25.25.7.2 (listing the documents the Service will request).

We strongly disagree with the Office of Chief Counsel on its conclusion. Their response relies on its own administrative guidance and does not squarely address the point that the IRS is asking for the *exact same* information from a taxpayer in a post-refund audit as it asks from a taxpayer in a pre-refund "non-audit." The Office of Chief Counsel advice is calling a wolf a lamb because it is wearing a sheepskin on its back. Because in our view the AQC review is an examination, the IRS must follow formal audit reopening procedures if it tried to conduct a subsequent examination on the tax return in question.[44]

The IRS may compromise the taxpayer's right to an appeal and impose unnecessary delays on the taxpayer while the IRS holds the PTC portion of the taxpayer's refund.[45] If the taxpayer replies to Letter 4800C and makes changes that do not match AQC's proposed changes, AQC sends Letter 89C, *Amended Return Required to Correct Account,* to require the taxpayer to file an amended return. If this procedure were properly characterized as an examination, and the IRS proposed an adjustment, the IRS would offer the taxpayer administrative appeal rights, and the taxpayer would eventually have the right to appeal in the U.S. Tax Court upon receiving the statutory notice of deficiency.[46]

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44 The audit reopening procedures can be found in Rev. Proc. 2005-32, 2005-23 I.R.B. 1206 (June 6, 2005); IRM, 1.2.13.1.1, *Policy Statement 4-3* (Dec. 21, 1984).

45 IRM 25.25.7.3, *AQC Initial Case Processing* (Jan. 9, 2015).

46 In the AQC process, the taxpayer may also face additional delays. If the taxpayer submits an amended return to AQC and the amended return changes the amount of the PTC other than the amount proposed by AQC, the taxpayer's return must then go through the IRS AM function to process the amended return. IRM 25.25.7.4, *Taxpayer Responses* (Aug. 25, 2015). AM reviews the claim for examination criteria and refers it to Examination if the criteria are met. IRM Exhibit 21.5.3-1, *Claim Processing with Examination Involvement* (Oct. 1, 2014). If these returns were sent to Examination from the onset, there would be no need for AQC and AM involvement, which created taxpayer burden and caused unnecessary delays. IRM 25.25.7.4, *Taxpayer Responses* (Aug. 25, 2015).

We understand that the IRS has a responsibility to protect revenue and avoid issuing improper refunds. However, we believe the IRS can achieve this goal without violating the statutory restrictions on multiple audits. It needs to coordinate the detection of PTC discrepancies with the detection of other questionable claims by the IRS's other systems (*e.g.*, the Dependent Database or Electronic Fraud Detection System). It can include all such concerns in one pre-refund or post-refund contact with the taxpayer. This approach not only protects taxpayers' rights and comports with the law, but it is also a highly efficient use of IRS resources, and minimizes taxpayer burden.

Taxpayers Who Receive Certain Lump Sum Payments After Receiving APTC May Be Caught Off Guard by Having to Repay Large APTC Amounts As Well As Penalties and Interest

To be an eligible taxpayer for the PTC, a taxpayer's household income (HHI) for the taxable year should be between 100 to 400 percent of the federal poverty line (FPL) for their family size.[47] When the taxpayer applies for coverage, the Marketplace estimates the amount of the PTC that the taxpayer can claim for the year using information provided about family composition and projected HHI. Based upon that estimate, the taxpayer may decide to receive the amount of PTC in advance.[48] If the PTC and APTC were calculated based on projected income between 100 and 400 percent of FPL, but the taxpayer's actual HHI calculated on the tax return is more than 400 percent of the FPL, the taxpayer must repay the full amount of the excess APTC (the amount by which APTC exceeds the PTC allowed).[49]

> When the IRS doesn't classify these tax Automated Questionable Credits adjustments as an examination, the IRS does not trigger the taxpayer's right to avoid unnecessary examinations.

The IRS and HHS remind taxpayers who receive APTC to report change in circumstances, including changes in income, to the Marketplace as soon as possible to prevent instances of having to repay APTC amounts.[50] It is likely that many taxpayers were not aware of the complex consequences of receiving lump sum amounts of certain types of income. It is our understanding that some taxpayers who receive lump sum amounts from retroactive awards of Social Security disability are required to repay the full amount of APTC because the lump sum amounts push HHI above the 400 percent FPL limit.[51] TAS is currently reviewing this issue to determine the need for increased outreach communications to alert appropriate APTC recipients to possible consequences of receiving large lump sum distributions.

The Absence of the SLCSP Amounts on Some Forms 1095-A Are Delaying the Processing of PTC Returns and Imposing Unnecessary Burden on Taxpayers

Taxpayers who receive coverage from the Marketplace receive Form 1095-A, *Health Insurance Marketplace Statement*. Part III of Form 1095-A should provide the SLCSP amount, which is used to calculate the PTC or reconcile the amount of

47 IRC § 36B(c)(1).

48 If the taxpayer is eligible for and decides to receive APTC, the Marketplace sends payments directly to the insurance provider on the taxpayer's behalf, reducing the taxpayer's out-of-pocket premium expense. If the taxpayer receives the APTC, the taxpayer must reconcile the payments made on his or her behalf with the actual PTC allowed on the tax return, as computed on Form 8962, *Premium Tax Credit (PTC)*. IRC § 36B(f).

49 The repayment cap in IRC § 36B(f)(2)(B) does not apply to taxpayers whose HHI exceeds 400 percent FPL.

50 *See* IRS Pub. 5152, *Report Changes to the Marketplace as They Happen: Important Reminder About Advance Payments of the Premium Tax Credit*.

51 Systemic Advocacy Management System (SAMS) entries, on file with the National Taxpayer Advocate. SAMS is a database of issues and information reported by IRS employees and the public. TAS reviews each SAMS submission and elevates them to the IRS for advocacy and resolution as appropriate.

APTC received on Form 8962. However, if the taxpayer purchased insurance through the Marketplace, and chose not to receive the credit in advance, the Marketplace issued the TY 2014 Form 1095-A without the SLCSP information. When the taxpayer filed the TY 2014 tax return, with the Form 8962 to claim a PTC and filled in the SLCSP based on information from the Marketplace at the time of enrollment, it causes a mismatch to occur.

It is our understanding that some taxpayers who receive lump sum amounts from retroactive awards of Social Security disablity are required to repay the full amount of Advanced Premium Tax Credit because the lump sum amounts push household income above the 400 percent Federal Poverty Line limit.

The absence of the SLCSP on Form 1095-A is very confusing to taxpayers. IRS Publication 974, *Premium Tax Credit,* directs the taxpayer to SLCSP premium tools on the Federally-facilitated or state Marketplace websites to look up the SLCSP premium that applies to the taxpayer's coverage family for each month.[52] The Internal Revenue Manual (IRM) is silent on supporting documentation employees can accept from taxpayers when the SLCSP information on Form 1095-A is blank or incorrect.[53]

The lack of procedural guidance on this issue could cause delays in processing returns even when taxpayers follow guidance provided in Publication 974 or on Healthcare.gov. TAS received reports regarding IRS employees refusing to accept taxpayer SLCSP documentation that was either not directly provided by the Marketplace or that couldn't be verified by IRS resources.[54]

Taxpayers need to go directly to the Marketplace to get that information on their own, but this is something that is available early on and the Marketplace should include it on all Forms 1095-A, regardless of whether the taxpayer received the APTC. Such a seemingly minimal effort on part of the Marketplace should significantly reduce burden on both taxpayers and the IRS. The IRS should reform its rules for exchange reporting on Forms 1095-A and require the Marketplace to provide the SLCSP amounts on all such forms.

The Inability of Health Insurers and Self-Insured Employers to Match TINs Before Filing Leads to Unnecessary Mismatches and Notices, Increasing Issuer Burden and Wasting IRS Resources

The IRS has not expanded the TIN matching program to health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.[55] The current e-Services TIN Matching Program (TMP) allows participating payers of reportable payments subject to backup withholding under IRC § 3406(b) to match the TIN and name of payees subject to potential backup withholding with IRS

52 IRS Pub. 974, *Premium Tax Credit*, 16 (rev. Mar. 2015).

53 IRM 3.12.3.75.9, *Error Code 198, Form 8962, Annual/Monthly SLCSP Amount(s) (ACA)* (Jan. 1, 2015), instructs the examiner to compare Form 1095-A data with taxpayer's SLCSP entries on Form 8962. If the amounts do not match or Form 1095-A is not present on the IRS system, the IRS sends correspondence to the taxpayer. If the taxpayer replies providing a Form 1095-A, the IRM instructs the examiner to compare the Form 1095-A provided by the taxpayer with taxpayer's entries on Form 8962.

54 SAMS entries, on file with TAS.

55 IRC § 6055. Currently, the law authorizes the IRS TIN Matching program only for payers of reportable payments subject to backup withholding. *See* IRC § 3406; Treas. Reg. § 31.3406(j)-1; Rev. Proc. 2003-9, 2003-8 I.R.B. 516 (Feb. 24, 2009).

records prior to filing the information report.[56] Using the TMP helps payers avoid penalties for submitting incorrect TINs on information returns.[57]

TMP would benefit the filers of Forms 1095-B which provide the names and TINs of all covered individuals and the months for which they had MEC. The IRS will use the forms to verify an individual's compliance with the ISRP. The reporting entities are required to begin filing the forms during FS 2016.[58]

Many Form 1095-B filers have never had to verify the accuracy of the name/TIN information and the inability to verify the information before issuing the forms could cause inaccurate TIN reporting. If information returns with incorrect or incomplete names or TINs are submitted (because the issuers are not able to run the numbers through the IRS TIN matching program before filing), the IRS will not be able to verify that individuals have MEC. Therefore, even covered individuals could receive notices imposing the ISRP.[59]

CONCLUSION

During FS 2015, the IRS faced a few unanticipated challenges that resulted in increased taxpayer burden with respect to the ACA. In general, the IRS has sufficiently addressed the issues as they arise in order to avoid similar issues in future filing seasons. The National Taxpayer Advocate remains concerned about the burdens imposed on taxpayers who received APTC, but failed to file their TY 2014 returns by the time the IRS must verify income and family size for re-enrollment in 2016. We are also concerned that AQC procedures for APTC mismatch and reconciliation issues are in fact an examination and therefore leave taxpayers at risk of multiple examinations of the same tax return. Taxpayers and the IRS are unnecessarily burdened when the Marketplace leaves the SLCSP amounts blank on Forms 1095-A for taxpayers that choose not to receive the APTC. Accordingly, TAS will work with the IRS and advocate to ensure the changes we recommend are adopted so that taxpayers are not burdened.

56 IRM 5.19.3.4.1.6, *e-Services Taxpayer Identification Number (TIN) Matching Program* (Apr. 23, 2014).

57 The TMP would also prevent the assessment of penalties on the businesses filing the forms. The penalty for failure to file a correct information return is generally $100 and the penalty for failure to furnish a correct payee statement is also generally $100. IRC §§ 6721, 6722. The IRS will not impose the penalty if the filer shows the failure was due to reasonable cause and not willful neglect. IRC § 6724. *See* Legislative Recommendation: *Affordable Care Act Information Reporting: Allow Taxpayer Identification Number Matching for Filers of Information Returns Under IRC §§ 6055 and 6056*, *infra*.

58 Notice 2013-45, 2013-31 I.R.B. 116 (July 29, 2013); T.D. 9660, 2014-13 I.R.B. 842 (Mar. 24, 2014).

59 IRC § 5000A. Insurers could also receive avoidable penalty assessments arising from such mismatches. Michael M. Lloyd and S. Michael Chittenden, *Expand TIN Matching Program to Avert Another ACA Debacle*, Tax Notes Today (Jan. 15, 2014).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Take preventative measures to avoid ISRP overpayments in the future, such as distributing educational notices about exemptions and exclusions to preparers associated with such overpayments and conducting a comprehensive review and testing of tax filing software to ensure that the problems that arose in FS 2015 do not recur.
2. Issue guidance to field compliance employees to assist them in identifying returns with a tax liability resulting from the correction of Forms 1095-A errors in the SLCSP information and not pursuing collection, including blocking the accounts from refund offsets.
3. 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.
4. Conduct outreach and education to inform taxpayers early in FS 2016 about the consequences of filing for an extension if the taxpayer received APTC. In particular, the information should provide the taxpayer with a specific date in 2016 by which the taxpayer needs to file the TY 2015 return in order to automatically re-enroll to receive APTC in 2017.
5. 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.
6. Conduct outreach and education on the consequences of receiving large lump sum distributions to APTC recipients as well as other organizations making such distributions, such as the Social Security Administration.
7. Issue guidance to both taxpayers (on the IRS website as well as in the Form 1095-A instructions) and IRS employees (in the IRM) about how taxpayers can use the look-up tool on Healthcare.gov to find their SLCSP premium amount.
8. Provide a similar IRS tool to ensure IRS employees can look-up the SLCSP amount and verify the amount provided by the taxpayer. The IRS should provide employees training on the use of the tool.
9. Reform the rules for exchange reporting on Form 1095-A and require the Marketplace to provide the SLCSP amounts on all such forms.
10. Expand the TIN matching program to include health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.

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

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division
Glenn Coles, Director, Identity Theft Victim Assistance Unit

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF 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.[2] Identity theft victims must substantiate their identity with the Internal Revenue Service (IRS), file various forms, and wait months or even years to receive their tax refunds and unwind the account issues.[3]

The National Taxpayer Advocate first raised concerns with the IRS's ability to resolve IDT cases in her 2004 Annual Report to Congress.[4] Since then, the IRS has grappled to find the best approach for working IDT cases. In fiscal year (FY) 2012, the IRS dispersed responsibility for working IDT cases by creating more than 20 specialized IDT units.[5] In FY 2015, the IRS changed course and reorganized its IDT victim assistance functions, centralizing them under one umbrella within the Wage and Investment (W&I) division.

The National Taxpayer Advocate is pleased with this reorganization, as she has long held the belief that a centralized approach to IDT victim assistance was necessary.[6] However, the National Taxpayer Advocate remains much more concerned with the IRS's IDT victim assistance *procedures* than she is with the *organizational structure* of the IDT victim assistance unit. Since 2004, the National Taxpayer Advocate has made 46 recommendations to the IRS in her Annual Reports to Congress on improving its IDT victim

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

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

3 National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

4 National Taxpayer Advocate 2004 Annual Report to Congress 133-36.

5 National Taxpayer Advocate 2012 Annual Report to Congress 45-46.

6 The National Taxpayer Advocate stated in her 2013 Annual Report to Congress that "the IRS should set up a centralized identity theft unit similar to the centralized innocent spouse unit that assists taxpayers who may have been victims of domestic abuse." *See* National Taxpayer Advocate 2013 Annual Report to Congress 75.

assistance, over half of which the IRS has eventually adopted.[7] Although improvements have been made over the years, the IRS can still do much more to assist victims of IDT.

The continuing 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 FY 2015.[8] This growth was caused, in part, by certain IRS screening mechanisms; in one program, approximately one out of three returns suspended by the IRS were legitimate returns.[9]

In Volume 2 of the National Taxpayer Advocate's 2014 Annual Report to Congress, she made numerous recommendations to improve the IRS's IDT victim assistance procedures, including:

1. IDT victims with multiple issues should be assigned a sole IRS contact person (and provided with a toll-free direct extension to this contact person) who would interact with them throughout and oversee the resolution of the case, no matter how many different IRS functions need to be involved behind the scenes.
2. The IRS should track IDT cycle time in a way that reflects the taxpayer's experience more accurately — from the time the taxpayer submits the appropriate documentation to the time the IRS issues a refund (if applicable) or otherwise resolves all related issues.
3. The IRS should review 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.[10]

Identity theft victims must substantiate their identity with the IRS, file various forms, and wait months or even years to receive their tax refunds and unwind the account issues.

The National Taxpayer Advocate believes adoption and implementation of these recommendations will improve the IRS's ability to effectively resolve IDT cases. In addition, the IRS should expand its Identity Protection Personal Identification Number (IP PIN) pilot to allow all taxpayers the option to receive an IP PIN. This would not only provide taxpayers a right to quality service, but also protect the federal fisc.

In October 2015, the IRS began re-engineering its IDT victim assistance procedures, and has included TAS among the stakeholders in this re-engineering effort. The Re-engineering Team plans to make significant improvements in IDT victim assistance; however, the IRS has not yet agreed to any of the recommendations listed above.

7 The IRS adopted (fully or in part) 25 of the 46 recommendations on improving IDT victim assistance made by the National Taxpayer Advocate. Some of the adopted recommendations include:
- Standardize procedures as to what information is required from taxpayers complaining of stolen identities (National Taxpayer Advocate 2004 Annual Report to Congress 142; adopted in 2009);
- The IRS should use an electronic indicator on its master files to mark the accounts of taxpayers who have verified that they have been victims of identity theft (National Taxpayer Advocate 2005 Annual Report to Congress 191; adopted in 2008);
- The IRS should develop a form that taxpayers can file when they believe they have been victims of identity theft (National Taxpayer Advocate 2007 Annual Report to Congress 115; adopted in 2009); and
- Require the Identity Protection Specialized Unit (or in the case of a single-issue case, the specialized function) to conduct final global account reviews on all identity theft cases (National Taxpayer Advocate 2012 Annual Report to Congress 67; adopted in 2013).

8 *See* TAS Business Performance Review (BPR), FY 2015 (Oct. 1, 2015).

9 *See* IRS, W&I BPR, CY 2015 Results through September (Nov. 2, 2015) (showing a false positive rate of 34.6 percent for the Dependent Database IDT filters).

10 *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

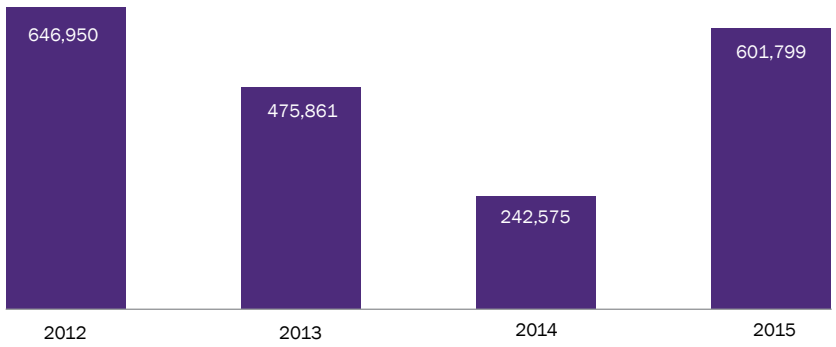
ANALYSIS OF PROBLEM

Background

The IRS continues to see a significant number of IDT cases. 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.[11]

FIGURE 1.16.1[12]

IRS Identity Theft Inventory on September 30, 2012-2015



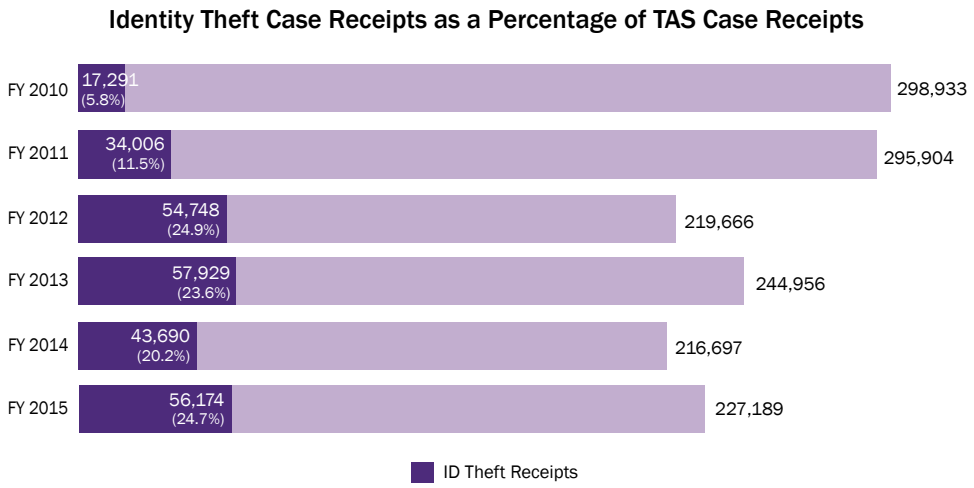
Identity theft cases continue to make up a significant percentage of TAS caseload as well. TAS IDT cases increased nearly 30 percent from FY 2014 to FY 2015. In FY 2015, TAS received more than 56,000 IDT cases representing 25 percent of all TAS cases. In FY 2014, TAS received nearly 44,000 IDT cases representing 20 percent of all TAS cases.[13]

11 IRS, *Global Identity Theft Report* (Sept. 30, 2015); IRS, *Global Identity Theft Report* (Sept. 30, 2014).

12 IRS, *Global Identity Theft Report* (Sept. 30, 2015); IRS, *Global Identity Theft Report* (Sept. 30, 2014); IRS, *Global Identity Theft Report* (Sept. 30, 2013); IRS, *Global Identity Theft Report* (Sept. 30, 2012).

13 TAS received 56,174 IDT cases in FY 2015 and 43,690 IDT cases in FY 2014. *See* TAS BPR, FY 2015 (Oct. 1, 2015); TAS BPR, FY 2014 (Oct. 1, 2014).

FIGURE 1.16.2[14]



A significant portion of the TAS IDT cases in FY 2015 is attributable to the failure of the IRS to properly administer its Taxpayer Protection Program (TPP).[15] The IRS uses advanced analytics to select and suspend the processing of tax returns it suspects were filed by identity thieves. When an IRS filter stops a return, the IRS sends the taxpayer a letter asking him or her to either call the TPP phone number or visit the Out-of-Wallet website to verify his or her identity. It turned out that approximately one out of three returns suspended by the TPP were legitimate returns,[16] resulting in a severe backlog of calls to the TPP toll-free phone line. As shown in this figure below, the level of service (LOS) on the TPP line was particularly poor during the 2015 filing season, when the LOS dipped below ten percent for three consecutive weeks.[17]

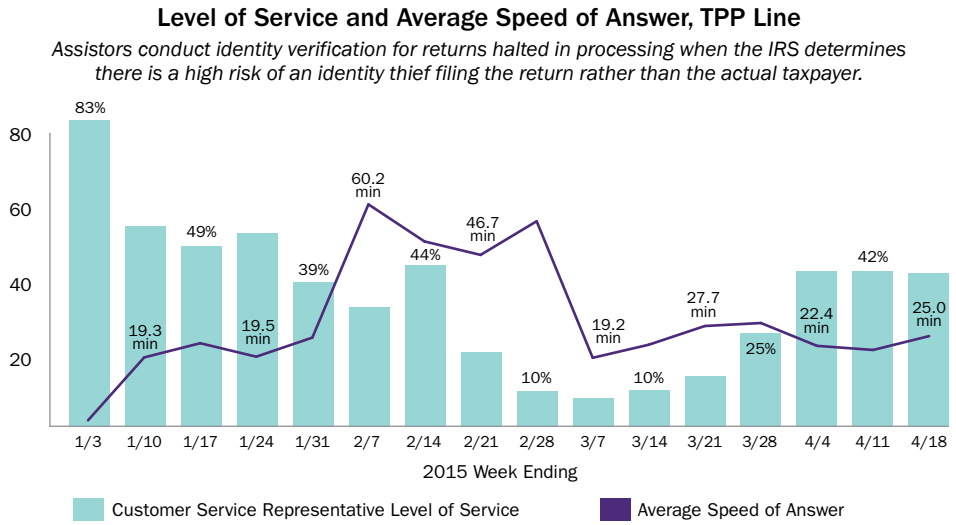
14 Taxpayer Advocate Management Information System (TAMIS), *Receipts – Core Issues by BOD & Criteria – Cumulative* (run dates Oct. 1, 2015; Oct. 1, 2014; Oct. 1, 2013; Oct. 1, 2012; Oct. 1, 2011; Oct. 1, 2010).

15 Of the 56,174 IDT cases (primary issue code 425) received by TAS in FY 2015, 37,686 (67 percent) involved issues stemming from the TPP. TAMIS (run date Oct. 1, 2015); IRS Compliance Data Warehouse (CDW), Individual Master File (Oct. 2015).

16 IRS, *IRS Return Integrity & Compliance Services (RICS), Update of the Taxpayer Protection Program (TPP)* 9 (June 24, 2015).

17 IRS, Joint Operations Center, *TPP Snapshot Reports* (Jan.–Apr. 2015). The IRS attributes the low LOS for the TPP line to a number of factors, including budget challenges that impacted all toll-free lines, problems with the Out-of-Wallet website, and multiple weather-related closures in TPP call sites. Additional staff for TPP were trained and added in late March to improve LOS. Email from Senior Tax Analyst, Business Performance Laboratory, Return Integrity and Compliance Services (July 6, 2015).

FIGURE 1.16.3[18]



Reorganization

In February 2014, the IRS began to consider the feasibility of adopting a centralized approach to IDT victim assistance. As a result of this feasibility study, the IRS decided to take the following actions:

- Centralize Accounts Management (AM) IDT caseworkers, including the Identity Protection Specialized Unit (IPSU), in a single IDT Victim Assistance (IDTVA) organization;
- Centralize Small Business/Self-Employed and W&I Compliance specialized teams within IDTVA;
- Realign the Office of Privacy, Governmental Liaison, and Disclosure's Identity Protection analysts to W&I; and
- Realign Compliance headquarters analysts supporting IDT to the Customer Account Services (CAS) organization.

With this reorganization, the AM Director is now able to lead all IDT staff — including policy analysts — to ensure that IDT cases are worked consistently and tracked more easily. In addition, the IRS consolidated the Internal Revenue Manual (IRM) effective October 1, 2015, so that all IDT procedures fall under a single IRM chapter.[19]

The new IDT Victim Assistance unit will require its employees (including IDTVA Compliance employees) to use the Correspondence Imaging System (CIS) beginning in FY 2016. Documents and notes uploaded on CIS will allow any IRS employee with access to CIS to quickly get up to speed on a case. Using CIS will also allow the IRS the ability to balance the IDT work more effectively. Furthermore, having all IDT cases on one system will enable the IRS to more easily track the cycle time for IDT cases, which is something the National Taxpayer Advocate has pushed the IRS to do.[20]

18 IRS, Joint Operations Center, *TPP Snapshot Reports* (Jan.–Apr. 2015).
19 IRM 25.23, *Identity Protection and Victim Assistance* (Oct.1, 2015).
20 *See* National Taxpayer Advocate 2013 Annual Report to Congress.

Results of 2014 Research Study

To gain a better understanding of what is really going on in the IRS inventory of IDT cases, TAS conducted a research study in 2014 where we (in coordination with W&I) pulled a representative sample of IDT cases from IRS inventory.[21] The results of this comprehensive review confirmed many of the observations the National Taxpayer Advocate has shared over the past decade about how the IRS can improve its IDT victim assistance.

Here are three findings from the 2014 study that merit attention:

1. *Overall, about two-thirds (67 percent) of all IDT modules in our representative sample were either (1) worked in more than one function, or (2) reassigned to another assistor within a function*.[22] A typical IDT victim who receives assistance from the IRS will be forced to bounce around from one assistor to another. Without a sole contact person assigned, there is a concern that an IDT case may fall through the cracks. Forty-two percent of the IDT modules analyzed in our sample had periods of inactivity (*i.e.*, periods of time when no work was being performed on the case for more than 30 days), with an average (mean) period of inactivity was 78 days.[23]
2. *In 22 percent of IDT cases in our representative sample, the IRS closed an IDT module without taking the appropriate steps to fully resolve the victim's account*.[24] In our study, the IRS closed many IDT cases before all account actions were taken — for example, some IDT victims had not yet received their refund, the IRS failed to issue an Identity Protection Personal Identification Number (IP PIN), or update the victim's address.[25] This brings into question the effectiveness of the IRS's global account review process. Either the procedures are insufficient or the IRS needs to ensure its assistors are trained better.
3. *The average cycle time for the IDT cases in our representative sample was 179 days (nearly six months)*.[26] While some functions (such as AM) tracked how long IDT cases stayed in their inventory, there was no standard calculation of cycle time across the IDT functions. The cycle times reported by various IDT specialized units did not reflect the time that has passed since the taxpayer filed a return or the time spent interacting with other functions. We believe this measure of 179 days more accurately indicates how long the IRS takes to resolve IDT cases, from the perspective of the IDT victim.

The Senate Appropriations Committee agreed with the National Taxpayer Advocate that the IRS should create a sole point of contact to deal with identity theft victims with multiple tax issues.[27] The Committee

21 See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

22 See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 52.

23 *Id.*

24 *Id.* at 53.

25 Of the 85 modules that we noted were prematurely closed, nine remained open as of Oct. 27, 2015.

26 See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 52-53.

27 S. Rep. 114-97, at 34 (2015), *available at* www.congress.gov/114/crpt/srpt97/CRPT-114srpt97.pdf ("Some identity theft victims have only a single issue that requires resolution, but many victims have multiple issues that must be resolved before the IRS will issue their refunds. In addition, these victims often have to call the IRS numerous times and speak with numerous employees.... The Committee also directs IRS to report on the feasibility of assigning the cases of identity theft victims with multiple issues to a single IRS representative (and provide victims with a toll-free direct extension to this representative) who will manage the case, including coordinating the actions of different IRS functions, and work with the taxpayer until the case is fully resolved.").

further directed the IRS issue a report detailing procedural changes aimed to cut the cycle time of identity theft cases in half.[28]

Re-Engineering Team

In September 2015, the IRS convened the IDT Re-engineering Team, a group of employees from across various functions empowered to make recommendations to improve the processing of IDT cases.

The IDT Re-engineering Team has formed sub-teams, including ones focused on improving the content and format of the IDT Global Report, strengthening global review procedures to ensure all actions are taken prior to closing an IDT case, and revisiting the role and scope of the IPSU. The IDT Re-engineering Team is led by the Director of the IDTVA organization and expects to submit recommendations to the Director of Accounts Management in early 2016.

IP PIN Expansion

In December of each year, the IRS issues IP PINs to certain victims of IDT whose identities and addresses have been verified.[29] An IP PIN is a unique code that some taxpayers must use, along with his or her taxpayer identification number, to file electronically.[30] IP PINs are a very effective way to prevent refund-related IDT; a would-be identity thief simply cannot e-file a tax return on a protected account without entering the IP PIN (which changes every year).

The average cycle time for the Identity Theft (IDT) cases in our representative sample was 179 days (nearly six months).

In 2014, the IRS conducted a pilot to expand the issuance of IP PINs. Residents of the District of Columbia, Florida, and Georgia were given the opportunity to opt-in to receive an IP PIN, regardless of whether or not they were victims of IDT.[31] Although uptake was relatively low (0.08 percent), the IRS continued the IP PIN opt-in pilot for residents of these three high-risk states in 2015.[32] One possible reason for the low uptake is the lack of effective outreach or notice about the program. For example, the National Taxpayer Advocate is a resident of the District of Columbia; she received no communication from the IRS that she could apply for an IP PIN for the 2015 filing season. Whether it involves mailing notices to all eligible taxpayers, using traditional or social media, or working with third parties such as tax software companies, the IRS can and must do better than achieving an uptake rate of less than 0.1 percent for such a valuable, no-cost service.

The IRS is currently exploring the feasibility of expanding the IP PIN opt-in pilot to nationwide, but is concerned about the costs of administering the program. The IRS estimates that it costs as much as $36 per IP PIN over a three-year period (the costs of issuing replacement IP PINs are factored into this estimate).[33] For each taxpayer who opted to receive an IP PIN in 2014, $193 of revenue was protected.[34]

28 S. Rep. 114-97, at 34 (2015), *available at* www.congress.gov/114/crpt/srpt97/CRPT-114srpt97.pdf ("The Committee directs the IRS to institute, and share with the Committee within 90 days of enactment, an updated action plan and timetable predicated on a goal of reducing by half the average amount of time a taxpayer must await a disposition of a refund fraud claim.").

29 IRM 25.23.2.21, *Identity Protection Personal Identification Number (IP PIN)* (Sept. 8, 2015).

30 *Id*.

31 IRM 25.23.2.21.2, *IP PIN Opt-In Available for Designated Taxpayers Who Are Not ID Theft Victims* (Sept. 8, 2015).

32 *Id*.; W&I Research and Analysis, IP PIN Opt-in Pilot Executive Checkpoint (Sept. 2015).

33 W&I Research and Analysis, IP PIN Opt-in Pilot Executive Checkpoint (Sept. 2015).

34 $2.2 million net revenue protected / 11,400 opt-ins in 2014. *See* W&I Research and Analysis, IP PIN Opt-in Pilot Executive Checkpoint (Sept. 2015).

In other words, the IRS stopped $5.36 in fraudulent refunds for every dollar it spent issuing IP PINs.[35] This is a conservative estimate which does not account for dollars protected in the second and third year of IP PIN use, while including the administrative cost of issuing IP PINs for three years. Based on these calculations, the IRS should secure the needed funds from Congress to expand the IP PIN opt-in program.

CONCLUSION

The National Taxpayer Advocate is pleased that the IRS leadership has decided to adopt the recommendation to change to a centralized approach to IDT victim assistance. With a centralized approach, the IRS is better positioned to evaluate and act upon the recommendations we made in our 2014 Annual Report to Congress. We look forward to working cooperatively with the new IDTVA unit to further improve service to this vulnerable population of taxpayers. We note that many of the ideas now under consideration by this unit were recommended by the National Taxpayer Advocate as far back as a decade ago. Had the IRS adopted these recommendations at that time, millions of taxpayers would have been spared tremendous anxiety, economic harm, and burden. The IRS should learn from this past lesson and not delay another ten years before embracing the recommendations in this report.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. For identity theft victims with multiple issues, assign a sole IRS contact person (and provide with a toll-free direct extension to this contact person) to interact with identity theft victims throughout and oversee the resolution of the case. Alternatively, the IRS should conduct a pilot where selected identity theft victims with multiple issues are assigned a sole employee, and compare results (case resolution time, number of contacts, taxpayer satisfaction, quality, etc.).
2. Track identity theft cycle time in a way that reflects the taxpayer's experience more accurately — from the time the taxpayer submits the appropriate documentation to the time the IRS issues a refund (if applicable) or otherwise resolves all related issues.
3. Review and adjust 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.[36]
4. Expand its IP PIN pilot to allow taxpayers in every state the ability to receive an IP PIN, and convey this option to taxpayers using multiple modes of communication.

35 $193 revenue protected / $36 cost of IP PIN issuance = $5.36 revenue protected per IP PIN issued.

36 *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

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

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

When a taxpayer who has a filing requirement fails to file a tax return, the IRS is authorized under Internal Revenue Code (IRC) § 6020(b) to use third-party information to determine and assess a tax liability.[2] 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.[3]

If a taxpayer has not filed a return and the IRS determines that a taxpayer has a filing requirement, it will typically select certain cases to prepare a Substitute for Return (SFR) and assess the liability based on information such as Forms W-2 and 1099 filed by employers, banks, and other third parties.[4] In preparing an SFR, the ASFR program generally treats the taxpayers as single (or married filing separately where there is evidence the taxpayer is married) with no dependents, allows one exemption and only a standard deduction (even where there is third-party documentation supporting deductions on file with the IRS).[5]

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 IRC § 6020(b).

3 Internal Revenue Manual (IRM) 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005). *See also* Treasury Inspector General for Tax Administration, Ref. 2014-30-023, *Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap* (Mar. 14, 2014).

4 IRM 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005).

5 IRM 5.18.1.3.5, *Tax Delinquency Investigation (TDI) Supplement Information* (Oct. 1, 2005); IRM 5.18.1.7.2, *Computing Taxable Income* (Oct. 1, 2005); IRM 5.18.1.7.3, *Computing Tax Due, Penalties and Interest* (Oct. 1, 2005). ASFR programming determines the filing status, taxable income, tax, interest, and penalties "systemically," *i.e.*, without an employee review.

The ASFR program has poor collection results and a high abatement rate:

- In fiscal year (FY) 2011 through FY 2014, the IRS assessed nearly $34 billion through its ASFR authority. The IRS collected less than one-third of this amount, nearly $11 billion.[6]
- For ASFR assessments made in FY 2011 through FY 2014, the IRS abated about $10 billion of the ASFR assessments — for a total of 29 percent of all ASFR assessments.[7]
- The ASFR program's return on investment (ROI) is small. In FY 2014, 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.[8]

The selection of these unproductive cases, which often result in abatement, cause rework for the IRS and potential harm to the taxpayer (*i.e.*, IRS attempts to collect the inflated liability by using its enforcement powers). The IRS could mitigate these outcomes by considering third-party documentation that supports deductions or credits when determining which cases to select for the program. Considering certain deductions and credits would result in a more accurate assessment, conserve IRS resources, and mitigate harm to taxpayers while protecting their rights.

ANALYSIS OF PROBLEM

Background

ASFR is the key IRS program for enforcing filing compliance by taxpayers who have not filed individual tax returns, but have incurred a "significant" tax liability.[9] The program estimates the liability by computing tax, penalties, and interest based upon information reported to the IRS by third parties.[10] When a taxpayer with reported income is delinquent in filing a return, the IRS attempts to secure the return

6 Individual Master File (IMF), Enforcement Revenue Information System (ERIS) on IRS Compliance Data Warehouse (CDW). The $34 billion assessed includes tax, penalties and interest. TAS Research worked closely with the ASFR Program Office to ensure that it was properly identifying ASFR cases. TAS and the IRS came very close in their data for ASFR cases and dollars collected through the ASFR program. However, there was a small difference in the number of cases and dollars collected. The numbers compiled by TAS Research showed about two percent fewer ASFR cases when compared to the ASFR Program Office's data, and showed about ten percent fewer dollars assessed compared to the ASFR Program Office's data.

7 IMF, ERIS on IRS CDW. Some ASFR abatements occur after the taxpayer files as the secondary taxpayer on a joint return; in such cases ERIS might not capture the tax assessed to and collected from a secondary taxpayer.

8 Office of the Chief Financial Officer, Financial Management, Office of Cost Accounting Cost-Based Performance Measures ASFR, FYs 2010 – 2014, *available at* http://cfo.fin.irs.gov/FinMgmt/Cost_Accounting/docs/Cost-Study-Reports/FY2014/ASFR-Cost_Study-FY_2014.doc (last visited May 28, 2015). The $89.5 million represents enforcement revenue collected by the ASFR program after an SFR notice has been issued and prior to the issuance of the first collection notice. Overall, IRS collected nearly $11 billion of assessments made in FY 2011 through FY 2014; however, the costs associated with the post-assessment collection, abatement, and other downstream tax account administration cannot be easily determined, making an accurate return on investment (ROI) calculation difficult.

9 IRM 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005). To meet ASFR processing criteria, the proposed tax liability must meet or exceed a predetermined dollar threshold established by the IRS for the ASFR program.

10 *Id*. The IRS can use information returns (*e.g.*, Forms W-2 and 1099) filed by employers, banks, and other third parties to report various types of payments to individuals. These payments include wages, interest, and dividends, as well as payments to self-employed taxpayers for services rendered. The IRS collects and maintains this information through the Information Return Program (IRP).

through correspondence. If the attempt is unsuccessful, the IRS is authorized by IRC § 6020(b) to prepare a substitute return for the taxpayer.[11]

In FY 2011, there were 279,374 Automated Substitute for Return (ASFR) assessed modules in which IRS received a Form 1098 showing mortgage interest expense; 85,151 of these accounts, or 30 percent, had tax abated, which IRS might have anticipated since many were qualified to itemize deductions and thereby incur a lower tax.

Generally, a return delinquency meets ASFR criteria when income information obtained through Information Returns Processing (IRP) is available for the delinquent tax module, the module is no older than five years prior to the current processing year, there are no related taxpayer delinquent accounts (TDAs), and the proposed tax liability is over a certain dollar threshold.[12] When the IRS selects a return delinquency for ASFR processing, the program calculates an estimated tax liability based on available income information with an assumed filing status of "single" or "married filing separate" with one exemption.[13]

Generally, this proposed liability exceeds what the taxpayer actually would owe on a self-reported return, because the ASFR return does not take into consideration the taxpayer's actual filing status, dependency exemptions, and deductions or credits.[14] The IRS notifies the taxpayer of the proposed assessment via a "30-day letter."[15] The taxpayer may respond with an original return, an agreement to the proposed ASFR assessment, or a statement indicating disagreement with the assessment. If the taxpayer disagrees or fails to resolve the return delinquency during this 30-day period (*i.e.*, does not respond to the 30-day letter), the IRS sends a Statutory Notice of Deficiency (90-day letter) to the taxpayer by certified mail.[16] If the taxpayer does not resolve the return delinquency or petition the U.S. Tax Court for relief within 90 days, the ASFR program assesses the proposed tax, penalties and interest, and collection action proceeds on any unpaid balance due.[17]

11 IRC § 6020(b): "(b) Execution of return by Secretary. — (1) Authority of Secretary to execute return. — If any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise. (2) Status of returns. — Any return so made and subscribed by the Secretary shall be *prima facie* good and sufficient for all legal purposes." IRM 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005). Some of the third-party forms used to match taxpayer data include Forms W-2 and Forms 1099 for miscellaneous, brokerage, interest, dividend, and cancellation of debt income.

12 IRM 5.18.1.3.1, *ASFR Criteria* (Dec. 9, 2014).

13 IRS response to TAS information request (Sept. 15, 2015). "ASFR uses a single filing status unless the taxpayer account shows a previous joint filing. Taxpayers with a previous joint filing receive a married filing separate filing status, consistent with SFR procedures. Per IRC § 6013(a)." IRS clarification (Dec. 11, 2015): "CCNIP (Case Creation Nonfiler Process) creates the tax calculation used to identify the Nonfiler population, including proposed liability amount and filing status. The calculation is forwarded to ASFR."

14 Government Accountability Office, GAO-08-728, *IRS Has a Complex Process to Attempt to Collect Billions of Dollars in Unpaid Tax Debts* 15 (June 2008). "An example in which additional information leads to abatements involves ASFR assessments. The IRS uses the best information available when it prepares returns for taxpayers who failed to file returns. When responding to the IRS-prepared return, taxpayers may provide additional information, such as on deductions to which they are entitled, which would produce a lower tax assessment compared to the ASFR-generated assessment. Accordingly, the IRS abates any assessed taxes and any applicable penalties associated with the ASFR return."

15 IRM 5.18.1.7.5, *Letter 2566 SC/CG (30-Day Letter)* (Feb. 24, 2015). The ASFR "30-day letter" provides the taxpayer with the proposed assessment amounts, and gives the taxpayer 30 days to respond. At the conclusion of the 30-day letter suspense period, if there is no/insufficient response, ASFR generates a Statutory Notice of Deficiency (90-day letter).

16 IRM 5.18.1.7.6, *Statutory Notice of Deficiency (ASFR 90-Day Letter)* (Oct. 1, 2005). The ASFR "90-day letter" (*i.e.*, the statutory notice of deficiency) notifies a taxpayer that the IRS intends to assess a tax deficiency. The notice also informs the taxpayer of the right to petition the Tax Court to dispute the proposed adjustments. The taxpayer has 90 days from the date of the notice to file a petition in the Tax Court before the tax is assessed.

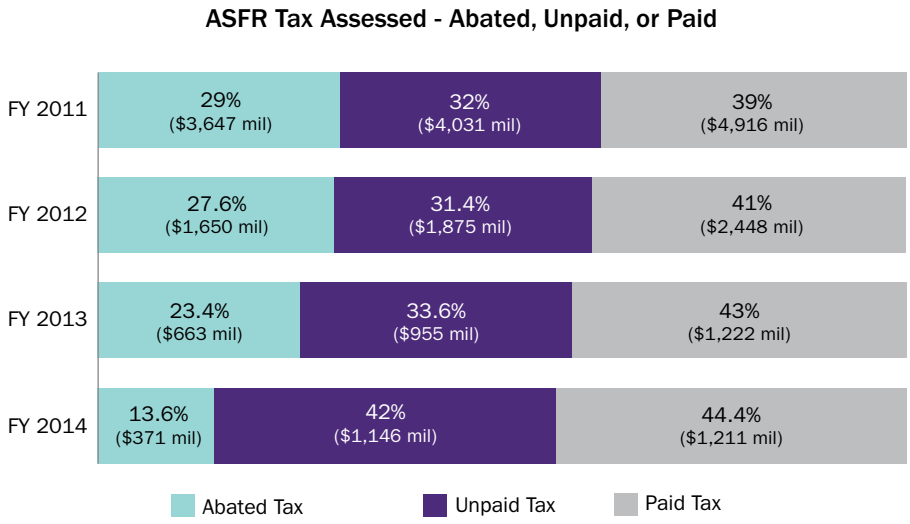
17 IRM 5.18.1.7(1) (Oct. 1, 2005).

Poor Collection Results and High Abatement Rates Show That ASFR's Selection Criteria Are Inefficient and Lead to Inflated Liabilities that Are Later Abated

Inflated Assessments Lead to Poor Collection Results

In FY 2011 through FY 2014, the IRS assessed nearly $34 billion through its ASFR authority.[18] The IRS collected nearly one-third of this amount, about $11 billion.[19] Figure 1.17.1 provides more specifics on the ASFR program's performance during FY 2011 through FY 2014.[20]

FIGURE 1.17.1



High Abatement Rate Is an Indication of Problematic Selection Criteria

In addition to the small percentage of dollars collected when compared to dollars assessed, the ASFR program's rate of abatement is significant. For ASFR assessments made in FY 2011 through FY 2014, the IRS abated nearly $1 for every dollar collected.[21] The high abatement rate can be attributed in part to the IRS not considering deductions and credits when selecting cases for ASFR. Figure 1.17.2 shows the percentage of assessed tax later abated for FY 2011 through FY 2014.

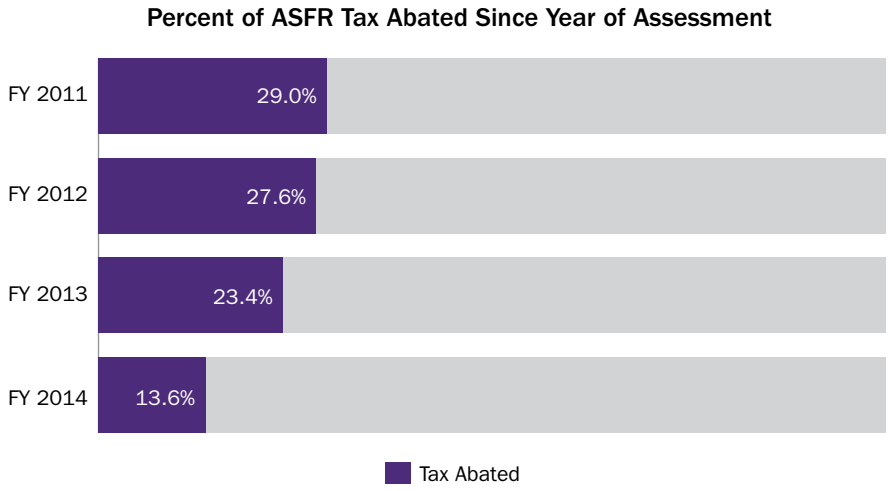
18 IMF, ERIS on IRS CDW.

19 *Id*. The $34 billion assessed includes tax, penalties and interest.

20 As noted above, some ASFR abatements occur after the taxpayer files as the secondary taxpayer on a joint return; in such cases ERIS might not capture the tax assessed to and collected from a secondary taxpayer.

21 IMF, ERIS on IRS CDW. Of the $34 billion of tax, interest, and penalty assessed, the IRS collected $10.7 billion and abated $9.8 billion.

FIGURE 1.17.2



As shown in the figure above, the amount of abatements is less in recent years, but these rates are likely to increase as time goes on, eventually reaching FY 2011 levels. As the IRS makes collection attempts (including refund offsets) on more recent ASFR assessments, taxpayers will file a return or provide documentation supporting deductions and credits, thereby resulting in a lower tax liability and abatement of the inflated ASFR liability. These abatement rates, coupled with the low collection results, indicate that the IRS should adjust its criteria for selecting cases for an ASFR assessment.

The approach of inflating a taxpayer's tax liability has several flaws. Inflating ASFR liabilities increases the number of ASFR cases that should not have been assessed in the first place. In other words, these cases only show a liability because the IRS did not consider deductions and credits. Specifically, the IRS could develop a selection algorithm that incorporates mortgage interest paid (as reported on Forms 1098), state income taxes paid (as reported on Forms W-2), and state sales tax per IRS tables. The IRS also could use historical data in the selection algorithm to include exemptions for dependents claimed on past returns and who were not claimed on another's return for the year in question. By including this information in the selection algorithm, the IRS will minimize the number of abatements, reducing both IRS rework and taxpayer burden.

The Low Return on Investment Raises Questions About the Usefulness of the ASFR Program

When taking into account the costs of the ASFR program, along with the collection results, and abatement rate, the usefulness of the program is questionable. According to an IRS report, the ASFR program cost $39.8 million in FY 2014. The $39.8 million does not include the costs of later abating liabilities, or the expense of sending out collection notices or making collection attempts. The revenue associated with the program prior to the IRS sending a first collection notice to the taxpayer was $89.5 million, which is a net gain of about $50 million.[22] Further, the report stated that it collected $2.25 for every $1 spent on the ASFR program.[23] This is a low ROI when compared to other IRS collection programs, and even then the ROI is overstated because it does not take into consideration the significant downstream costs

22 Office of the Chief Financial Officer, Financial Management, Office of Cost Accounting Cost-Based Performance Measures ASFR, FY 2010 – FY 2014.

23 *Id*.

attributable to abatement.[24] For example, for every dollar invested in other IRS programs, there can be monetary returns ranging from 6-to-1 and even up to 20-to-1.[25] Improving the selection criteria for the program would increase the return on investment; otherwise, the program as currently configured raises the question of whether the $39.8 million spent might be better applied elsewhere.

Considering Additional Information Prior to Selecting Cases for ASFR May Increase Program's Efficiency While Reducing Burden on Taxpayers

As noted above, the ASFR program could yield better results by carefully selecting which cases to pursue. This could be accomplished by considering third-party documentation (*i.e.*, documents the IRS has available to it that would support deductions and credits like the mortgage interest deduction or education deductions and credits) and prior year filing statuses.

In an effort to identify what generates abatements, and what type of information would be useful for the IRS to consider when selecting ASFR cases, TAS analyzed reason codes entered on abatements of ASFR liabilities for FY 2014. Unfortunately, the reason codes used are often vague and nondescript, and provide little information as to why the liability was abated. For example, the reason code most commonly entered was "reconsideration allowed in full." However, several of the codes did provide insight into what causes the abatement. The following are some of the most common reasons for abatement:

- Filing status (Married Filing Jointly);
- Filing status (Head of Household); and
- Itemized deductions.

In regards to the different filing statuses (*i.e.,* changing from married filing separately to married filing jointly or head of household), the IRS could look at the past three filed returns and, if the taxpayer elected married filing jointly or head of household on those past returns, it could at least consider the selected status for the purpose of determining if the case would be well suited for the ASFR program. This approach is particularly appropriate where the spouse from earlier years has not filed a return of his or her own for the ASFR year. If it would substantially reduce or eliminate the liability, the IRS could make a business decision to not prioritize this particular case for ASFR development, because there is a high probability of abatement.

Another common reason for abatement of ASFR assessments is application of itemized deductions. Unfortunately, the reason code does not specify what itemized deductions generated the abatement. However, TAS Research was able to identify ASFR assessments that were abated due to the mortgage interest deduction. In FY 2011, there were 279,374 ASFR assessed modules in which IRS received a Form 1098 showing mortgage interest expense; 85,151 of these accounts, or 30 percent, had tax abated, which IRS might have anticipated since many were qualified to itemize deductions and thereby incur a lower tax.[26] In fact, over 60 percent of all ASFR accounts with Form 1098 show mortgage interest expense amounts larger than the standard deduction, indicating these taxpayers likely qualify to itemize, yet the IRS calculates their tax at a higher rate.[27]

24 Also note that, overall, IRS collected nearly $11 billion of assessments made in FY 2011 through FY 2014.

25 Statement of the Commissioner of Internal Revenue John Koskinen on the FY 2016 Budget (Feb. 2, 2015).

26 IMF, ERIS on IRS CDW. There were 2,230 modules with abated tax of about $49 million attributable to TC 594 CC 84 (modules abated because the taxpayer filed as a secondary taxpayer on a joint return).

27 *Id*.

The IRS already possesses third-party documentation regarding the mortgage interest deduction, and for many other itemized deductions and credits. This documentation is just as reliable as the third-party documentation used to determine a taxpayer's income. If the IRS is confident using third-party documentation to determine income, it should also take into account third-party documentation that would support deductions or credits when making a determination as to the use of its SFR authority.

The following are examples of the type of information that should be considered when determining if a case should be selected for the ASFR program, or if an ASFR assessment would likely result in abatement:

> **EXAMPLE 1:** Taxpayer failed to file a return for tax year 2014. In the three tax years prior to 2014, the taxpayer elected married filing jointly (MFJ) status and for those years either owed zero tax or was due a refund. Further research shows that the taxpayer's spouse did not file a separate return for 2014. The IRS made an ASFR assessment on the 2014 return and used the married filing separately status. By using the married filing separately status, the taxpayer had an ASFR liability that would have been lessened or possibly eliminated if the IRS used the MFJ filing status.
>
> **EXAMPLE 2:** Taxpayer did not file a return for tax year 2014. For the past five years preceding 2014, the taxpayer has taken the mortgage interest deduction. By claiming this deduction, the taxpayer had a minimal tax liability. The IRS made an ASFR assessment on the 2014 return and did not include the mortgage interest deduction, even though the IRS has this information. As a result, the IRS assessed a liability that exceeded the minimal amount had the IRS considered the mortgage interest deduction.
>
> **EXAMPLE 3:** Taxpayer failed to file his 2014 tax return. For the past three years, taxpayer claimed the maximum amount allowed for the education deduction for those years. As a result, taxpayer typically received a refund ranging from $250 to $500. The IRS made an ASFR assessment for 2014 and did not consider the education deduction, even though it has that information available to it. As a result, taxpayer was assessed an ASFR liability that would have been eliminated if the IRS considered information available on third-party information reports.[28]

The examples above illustrate that if the IRS had considered the taxpayer's prior filing status history, or third-party documentation that support credits or deductions, it might have decided to not include the case in the ASFR program. Not only would this strike a fairer balance in the ASFR program, thereby upholding a taxpayer's *right to a fair and just tax system*, it would also prevent the IRS from using resources to conduct an ASFR assessment on an account that would likely result in abatement if the taxpayer contacted the IRS and submitted documentation substantiating deductions and credits.

Although the IRS may ultimately decide that the case should not be included in the ASFR program after considering third-party documentation, it could instead send the taxpayer a letter saying, "We have information that you may be able to claim a tax credit and we haven't received your return. Please file." This might bring in the return without doing an unproductive ASFR. This approach promotes the taxpayer's obligation to timely file a return without producing an incorrect assessment that requires abatement.

28 *See* IRS Form 1098-T *Tuition Statement*. "You, or the person who can claim you as a dependent, may be able to claim an education credit on Form 1040 or Form 1040A."

Narrowing the Field of ASFR Cases Will Improve Case Resolution

If the IRS reduced the number of ASFR cases by using additional third-party documentation, it could focus on the remaining ASFR cases and attempt to actually contact the taxpayer. More specifically, IRS employees could first send out a soft notice that provides information about the ASFR and how to contact the IRS. This notice could inform taxpayers of the amount the IRS believes the taxpayer owes but also acknowledges that the enclosed list of third-party documentation shows the taxpayer may be entitled to certain deductions and credits.

Currently, the IRS does not disclose in its notice that it possesses any third-party information indicating that the taxpayer might qualify for additional deductions or credits, much less share them to assist the taxpayer with preparing a return.

If the IRS does not hear back from the taxpayer in a specified period of time, an IRS employee would attempt a phone call to reach this taxpayer and discuss avenues for resolution, including collection alternatives. Going this extra step with a smaller batch of ASFR cases — chosen through refined selection criteria — would ensure that the taxpayer's failure to respond was not due to an undelivered notice.[29] This approach will improve case resolution by focusing on a smaller number of cases and adding the element of in-person contact with taxpayers. It will also reduce rework and use the IRS's most expensive touches (phone calls and actual proposed assessment letters) with a much smaller pool of potentially delinquent taxpayers.

CONCLUSION

It is critical that the IRS designs its programs and its interactions with the public to encourage voluntary filing. The IRS designed the ASFR program to motivate taxpayers who had not filed a return, but had a requirement to do so, to contact the IRS and file such a return. However, as discussed above, the ASFR program largely fails to drive such behavior. Further, enforced collection actions are harming taxpayers and tying up IRS's own resources with unproductive cases where after applying exemptions, deductions and credits, information about which the IRS has in its possession through third-party reporting, the liability would be reduced to zero. The taxpayers would be better served if the IRS used selection criteria that considered additional third-party documentation in calculating a taxpayer's liability. This would ensure that the ASFR cases were worthy of IRS resources.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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.
2. 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.
3. When selecting cases for ASFR, consider third-party documentation that supports exemptions, deductions, and credits before making ASFR assessments.

29 National Taxpayer Advocate 2010 Annual Report to Congress 21.

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

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Problems obtaining Individual Taxpayer Identification Numbers (ITINs) have long plagued taxpayers who have a tax return filing requirement and need a taxpayer identification number, but are ineligible for a Social Security number (SSN).[2] 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.[3] 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 return filings have dropped precipitously, down 58 percent between 2011 and 2014.[4] While the general economic climate and immigration trends help explain this decline, IRS ITIN procedures have most certainly contributed to it. In 2012, in response to a Treasury Inspector General for Tax Administration (TIGTA) report alleging significant refund fraud connected to ITINs, the IRS made sweeping changes that require applicants to submit original identification documents (subject to a few alternatives) and has maintained its policy of generally requiring applicants to apply for an ITIN with a paper tax return during the filing season.[5] The requirements have led to extreme delays for ITIN

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 "Generally, noncitizens authorized to work in the United States by the Department of Homeland Security (DHS) can get a Social Security number." Social Security Administration, *Social Security Numbers for Noncitizens*, Publication No. 05-10096 (June 2015), *available at* http://www.socialsecurity.gov/pubs/EN-05-10096.pdf.

3 During processing years (PYs) 2012-2014 an average of 4.6 million Form 1040 returns were filed having an ITIN for either the primary or secondary (*e.g.*, spouse) filers or a dependent. IRS, Compliance Data Warehouse (CDW) (data retrieved on Dec. 15, 2015).

4 In PY 2011, the IRS received 2,317,374 ITIN applications (Form W-7), compared to 965,793 in PY 2014. IRS, *ITIN Comparative Reports* (Dec. 31, 2011; Dec. 31, 2014).

5 *See* IRS, IR-2012-98, IRS *Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season* (Nov. 29, 2012), *available at* http://www.irs.gov/uac/Newsroom/IRS-Strengthens-Integrity-of-ITIN-System;-Revised-Application-Procedures-in-Effect-for-Upcoming-Filing-Season.

While concerns about refund fraud are legitimate, the IRS's solutions 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*.

applicants. During the 2015 filing season, the IRS advised taxpayers to wait up to 11 weeks,[6] and at one point had a backlog of nearly 120,000 ITIN applications with returns.[7] While concerns about refund fraud are legitimate, the IRS's solutions 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. The advent of the Foreign Account Tax Compliance Act (FATCA) has exacerbated problems due to the greater impact of not timely receiving an ITIN.[8] The National Taxpayer Advocate is concerned that:

- 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.
- ITIN applicants are subject to unnecessary burden and risk losing their identification documents while the IRS creates more work for itself by not providing adequate alternatives to applicants submitting original documents.
- Combined, the requirements for most applicants to apply during the filing season and send original documents contribute to errors on the parts of the ITIN unit and ITIN applicants, resulting in growing suspension and rejection rates.
- Taxpayers abroad needing ITINs for information reporting purposes are especially burdened by the ITIN requirements and procedures.
- Future requirements for deactivating ITINs will deprive some taxpayers of ITINs they need for tax administration purposes, and the IRS policy will undermine taxpayers' *right to be informed*.

6 *See* IRM Procedural Update WI-03-0215-0352 (Feb. 19, 2015), *available at* http://www.irs.gov/pub/foia/ig/spder/WI-03-0215-0352%5b1%5d.pdf.

7 IRS, *ITIN Production Report* (March 28, 2015) showed 119,409 "applications [with return] awaiting input." IRS, *ITIN Production Report* (Mar. 14, 2015) showed 3,075 "applications [without return] awaiting input." Internal Revenue Manual (IRM) 3.21.263.8.3.1, *Preliminary W-7 Application Data Screen* (Sept. 4, 2014) instructs examiners to input as the IRS received date the stamped date or, if missing, the postmark or signature date, or the current date minus ten days.

8 *See* National Taxpayer Advocate FY 2016 Objectives Report to Congress 48-52 (Area of Focus: *The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*). *See also* 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*.

ANALYSIS OF PROBLEM

Background

Individuals ineligible for an SSN, including residents and nonresidents for tax purposes, need an ITIN to file a tax return or be claimed on another person's return.[9] Taxpayers without SSNs rely on ITINs to:

- File required tax returns if income is above the filing threshold and pay associated taxes;
- Claim tax benefits to which they are lawfully entitled, such as the dependency exemption[10] and the Child Tax Credit;[11]
- File joint returns or be claimed as dependents on the returns of primary taxpayers;
- Avoid mandatory withholding at the rate of 30 percent on certain payments of U.S. source income made by a foreign financial institution under the requirements of FATCA[12] and U.S. source income that is fixed, determinable, annual, or periodic;[13]
- File an election or apply for a withholding certificate under the Foreign Investment in Real Property Tax Act (FIRPTA) of 1980;[14]
- Claim tax treaty benefits to obtain reduced withholding rates; and
- Provide information to third parties such as financial institutions, requiring an ITIN for information reporting and withholding.

The ITIN population has changed significantly in recent years. In calendar year 2014, dependents comprised only 44 percent of ITIN applicants, compared to 68 percent of ITIN applicants in 2012.[15] Spouses, who made up about six percent of ITIN applicants in 2012, made up over 13 percent in 2014.[16]

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9 Taxpayers are required by law to use a taxpayer identifying number on tax returns, statements, or other documents required to be filed, when prescribed by regulations, and the regulations specify that this number must be an SSN unless the individual is ineligible for an SSN or is required to use an employer identification number. Internal Revenue Code (IRC) § 6109(a)(1); Treas. Reg. § 301.6109-1(a)(1)(ii)(A). Form W-7, *Application for IRS Individual Taxpayer Identification Number*, is the application that taxpayers use to apply for an ITIN.

10 An individual may generally claim a dependency exemption amount for a child (or younger descendant or that of a sibling or step-sibling) under 19 (24 if a full-time student) sharing his or her home for over half the year and who is a U.S. citizen or national, or a resident of the U.S., Canada, or Mexico, or for a qualifying relative. *See* IRC §§ 151(c), 152(b), (c), (d). Note, however, that terms of tax treaties between the U.S. and foreign countries may provide for residents of those countries to claim a dependency exemption if they meet certain conditions. *See, e.g.*, U.S.- Republic of Korea Income Tax Convention, Art. 4(7).

11 The Child Tax Credit and the refundable portion of it, known as the Additional Child Tax Credit, are generally available for children who meet the dependency exemption rules, with the additional requirement that they must also reside in the United States. *See* IRC § 24(a), (c), and (d).

12 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010). Under FATCA, participating foreign financial institutions (FFIs) who have reached agreements with the IRS to avoid being subject to systematic withholding must impose withholding on any of their own customers defined as "recalcitrant account holders." IRC § 1471(b)(1)(D)(i). *See* IRC § 1471(d)(6) (definition of "recalcitrant account holder"). Financial customers must provide the FFI with either a Form W-9, to certify they are U.S. persons, or a Form W-8BEN, to certify they are foreign persons, both of which require an SSN or ITIN. Taxpayers without an SSN or an ITIN will generally be treated as recalcitrant account holders and will be subject to withholding undertaken by the FFI. IRS response to TAS information request (Nov. 1, 2013). *See also* Treas. Reg. § 1.1471-4.

13 *See* IRC § 1441.

14 Pub. L. No. 96-499, Subtitle C, 94 Stat. 2599, 2682 (1980). FIRPTA imposes income tax on foreign persons disposing of U.S. real property interests.

15 IRS, Compliance Data Warehouse (CDW), Form W-7 Database (data drawn Dec. 15, 2015). All numbers refer to year end data. *See* National Taxpayer Advocate 2013 Annual Report to Congress 216.

16 Detailed information from ITIN applications (Form W-7) for PY 2015 are not reported here due to a programming error that caused only about half of Form W-7 records being transferred to the IRS's CDW from the ITIN Real Time System (RTS). The IRS informed TAS that the corrected data for 2015 would not be available until early/mid 2016 and suggested that TAS exclude characteristics of 2015 Form W-7 applicants from this report. Form W-7 data for PY 2014 and prior years have been corrected.

ITIN applications submitted by nonresidents increased over eight percent between 2013 and 2014 (from 100,285 to 108,472), which might be driven in part by an increased number of taxpayers needing ITINs to comply with FATCA. ITIN filers were only slightly more likely to claim a refund than SSN taxpayers, and the average refund for ITIN filers was slightly less than the average refund for SSN filers during the last two years.[17] In 2015, 4.4 million ITIN filers paid over $5.5 billion in payroll and Medicare taxes and $23.6 billion in total taxes.[18]

FIGURE 1.18.1, Type of ITIN Applicant and Country of Origin

		Type of Applicant				Top Three Countries of Origin		
Year	Total	Primary	Spouse	Dependent	Other	Mexico	Guatemala	India
2013	1,175,422	417,747	129,037	614,849	13,789	695,268	78,485	42,742
	100%	36%	11%	52%	1%	59%	7%	4%
2014	924,507	383,069	124,487	403,434	13,517	466,314	63,043	54,542
	100%	41%	13%	44%	1%	50%	7%	6%

FIGURE 1.18.2, Residency Status of ITIN Applicants and Application Exceptions[19]

		Residency Status			Top Three Application Exceptions		
Year	Total	Resident	Non-Resident	Other	Passive Income	Other Income	FIRPTA
2013	1,175,422	1,044,126	100,285	31,011	36,348	10,818	8,171
	100%	89%	9%	3%	3%	1%	1%
2014	924,507	781,650	108,472	34,385	32,243	13,265	9,728
	100%	85%	12%	4%	3%	1%	1%

17 IRS, CDW, Form 1040 Database (data drawn Dec. 15, 2015). All numbers refer to year end data except for 2015, which includes data through October 2015.

18 IRS, CDW, Form W-2 Database, Form 1040 Database (date drawn Dec. 16, 2015) (reflects data available from January to November 2015). An "ITIN filer" is defined as a tax return on which an ITIN was used for either the primary or secondary (*e.g.*, spouse) filer or a dependent. The $5.5 billion figure includes Federal Insurance Contributions Act (FICA) and Medicare taxes reported on Form W-2 by primary filers with an ITIN and primary filers with an SSN if the secondary filer or a dependent used an ITIN. This figure does not include FICA and Medicare tax paid by Form 1040 ITIN filers who used a different taxpayer identification number (*e.g.*, SSN) on Form W-2. IRS, CDW, Form W-7 data.

19 IRS, CDW, Form W-2 Database, Form 1040 Database (date drawn Dec. 16, 2015).

FIGURE 1.18.3, Summary Characteristics of ITIN and Non-ITIN Filers[20]

	2014		2015	
	ITIN	non-ITIN	ITIN	non-ITIN
Total Tax Returns	4,509,722	142,887,720	4,351,220	143,715,543
Returns with a Refund	3,582,839	111,415,130	3,429,365	110,734,488
	79%	78%	79%	77%
Returns with Balance Due	680,761	26,182,800	710,505	27,937,064
	15%	18%	16%	19%
Average Refund	$2,904	$3,321	$2,896	$3,363
Average Balance Due	$2,011	$5,332	$2,089	$5,566
Total Refund Amt ($M)	$10,405	$370,040	$9,931	$372,429
Total Taxes Paid ($M)	$22,505	$1,575,328	$23,601	$1,673,228
Taxes Withheld ($M)	$12,582	$1,042,237	$13,200	$1,097,267

The inability to obtain ITINs leads to negative consequences for taxpayers, international businesses, and the IRS, as illustrated by the following examples:

1. A foreign individual on a temporary (nonimmigrant) visa correctly obtains an SSN and pays taxes, as required, on the income earned working in the United States. His family undergoes financial hardship when he must forgo claiming the dependency exemption for his child and filing a joint return with his spouse, both residing in Mexico, because IRS procedures create barriers to them obtaining ITINs.[21]
2. A foreign investor who owns U.S. property applies for an ITIN six months in advance of an upcoming sale, leaving ample time for the IRS to process the ITIN and issue a withholding certificate. The IRS suspends her ITIN application without explaining why her supporting documents were insufficient. The investor delays the sale while she resubmits the same documents. By the time the IRS approves the ITIN application and the investor applies for and receives a withholding certificate, the sale has fallen through.
3. A resident for tax purposes, who is ineligible for an SSN, works as an independent contractor. He chooses not to file a tax return and pay taxes because he has witnessed others in his community who were unsuccessful in obtaining ITINs, even after paying certifying acceptance agents to assist them.

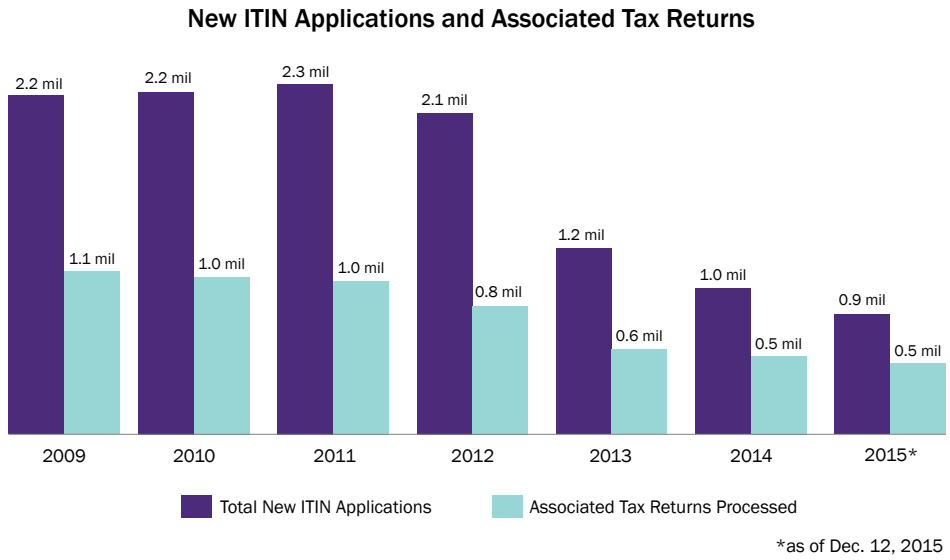
In 2012, TIGTA found the IRS's ITIN process was "so deficient that there is no assurance that ITINs are not being assigned to individuals submitting questionable applications."[22] While concerns about refund fraud are legitimate, the IRS's disproportionately restrictive approach to issuing ITINS does not effectively target the fraud while needlessly burdening taxpayers and preventing those with a legitimate need for an ITIN from obtaining one. Beginning in 2012, the numbers of new ITIN applications and associated returns have fallen significantly as shown in Figure 1.18.4.

20 IRS, CDW, Form 1040 Database (date drawn Dec. 16, 2015).

21 The documentation requirements for ITIN applications will be discussed below.

22 TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpaer Identification Number Program to Detect Fraudulent Applications* 6 (July 16, 2012).

FIGURE 1.18.4, New ITIN Applications and Associated Returns in PYs 2009–2015[23]



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

In 2003, despite the National Taxpayer Advocate's concerns about creating unnecessary administrative burden, the IRS began requiring most ITIN applications to be filed with a paper tax return during the filing season.[24] There are exceptions for nonresident individuals claiming the benefits of a tax treaty and having income, payments, or transactions subject to third-party reporting or withholding,[25] but these applicants are a minority.[26] ITIN applicants only have a short time to gather supporting documents and in many cases must give up original documents such as passports.[27] Some may not be able to apply for an ITIN at all if they are out of the country during the filing season and cannot send in their documents. Furthermore, filing an ITIN application with a return means applicants cannot electronically file their annual returns in the calendar year the ITIN is issued.

While this policy was ill-considered at its inception, the consequences have grown significantly worse. In 2003, the IRS processed ITIN applications in four to six weeks, and following the policy change, committed to two weeks.[28] During the 2015 filing season, the IRS advised taxpayers to wait up to 11 weeks,[29]

23 IRS, *ITIN Comparative Reports* (weeks ending Dec. 12, 2015; Dec. 31, 2014; Dec. 31, 2013; Dec. 29, 2012; Dec. 31, 2011, Dec. 30, 2010, and Dec. 31, 2009).

24 *See* National Taxpayer Advocate 2003 Annual Report to Congress 60-86 (Most Serious Problem: *Individual Taxpayer Identification Number (ITIN) Program and Application Process*).

25 *See* Form W-7 instructions (Dec. 2014).

26 In PY 2014, about 56,700 out of 924,500 ITIN applicants (six percent) claimed an exception to filing with a tax return. IRS, CDW, Form W-7 Database (data drawn Oct. 19, 2015).

27 The documentation requirements for ITIN applications will be discussed below.

28 *See* National Taxpayer Advocate 2003 Annual Report to Congress 79.

29 *See* IRM Procedural Update WI-03-0215-0352 (Feb. 19, 2015), *available at* http://www.irs.gov/pub/foia/ig/spder/WI-03-0215-0352%5b1%5d.pdf.

and at one point had a backlog of nearly 120,000 ITIN applications with returns.[30] This results in ITIN taxpayers waiting up to 14 weeks to receive their refunds, contrasted with the up to three weeks taxpayers with SSNs must wait.[31] The backlog also affected applicants who were exempt from the requirement to apply with a tax return.[32]

When questioned about the cause of the extended timeframe and backlog, the IRS cited funding decreases, which resulted in the delayed return of seasonal tax examiners by 30 days, a shorter filing season, an inability to provide overtime pay, and an overall decrease in employees.[33] However, seasonal employees and overtime would not be necessary and the length of the season would be irrelevant if the IRS were to process ITIN applications throughout the year.[34] The IRS maintains, "Associating the issuance of the ITIN with the filing of a tax return is the only reliable method for the IRS to verify the number is being requested and properly used for tax administration purposes."[35] However, in the case of a Form W-7 and Form W-2 name mismatch,[36] the IRS accepts copies of pay stubs or bank accounts as proof the income belongs to the applicant.[37] The IRS could accept these documents to determine that the taxpayer had a filing requirement and a proper tax administration purpose for an ITIN, throughout the year. This approach would acknowledge the need for a tax filing requirement, but balance the anti-fraud regime with the taxpayer's need for a process no more intrusive than necessary.

Requiring ITIN applications to be filed with returns results in lost returns, and until a recent policy change, it also led to unprocessed returns. More than one Low Income Taxpayer Clinic (LITC)[38] has reported instances where the IRS processed an ITIN application, but lost the associated return, which was submitted shortly before the refund statute of expiration date (RSED).[39] Although the IRS does not keep records of lost return complaints,[40] allowing taxpayers to apply for an ITIN earlier, and later file annual returns, including the option to electronically file, would reduce the opportunity for returns to be lost.[41]

As a result of TAS's advocacy, the IRS recently agreed to change its ITIN guidance and process all valid returns filed with an ITIN application. Prior to these changes, the Internal Revenue Manual (IRM) advised

30 IRS, *ITIN Production Report* (Mar. 28, 2015) showed 119,409 "applications [with return] awaiting input." IRS, *ITIN Production Report* (Mar. 14, 2015) showed 3,075 "applications [without return] awaiting input." IRM 3.21.263.8.3.1, *Preliminary W-7 Application Data Screen* (Sept. 4, 2014) instructs examiners to input as the IRS received date the stamped date or, if missing, the postmark or signature date, or the current date minus ten days.

31 *See* 2015 Tax Season Refund Frequently Asked Questions, *available at* http://www.irs.gov/Refunds/Tax-Season-Refund-Frequently-Asked-Questions (last updated Apr. 22, 2015).

32 The backlog led to a spike in the processing time for applications submitted without returns. At one point during the 2015 filing season, the IRS took approximately 35 days to process these ITIN applications, compared to 23 days in 2014. *See* IRS, *ITIN Production Report* (June 13, 2015).

33 *See* IRS response to TAS information request (Sept. 17, 2015).

34 IRS, *ITIN Production Report* (Mar. 28, 2015) showed 119,409 "applications [with return] awaiting input." IRS, *ITIN Production Report* (March 14, 2015) showed 3,075 "applications [without return] awaiting input." IRM 3.21.263.8.3.1, *Preliminary W-7 Application Data Screen* (Sept. 4, 2014) instructs examiners to input as the IRS received date the stamped date or, if missing, the postmark or signature date, or the current date minus ten days.

35 *See* National Taxpayer Advocate FY 2015 Objectives Report to Congress vol. 2, 87.

36 *See* Form W-7, *Application for IRS Individual Taxpayer Identification Number*, and Form W-2, *Wage and Tax Statement*. A name mismatch occurs when the taxpayer's name on the Form W-7 is different from the taxpayer's name on Form W-2.

37 *See* IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Aug, 18, 2014).

38 *See* IRC § 7526.

39 TAS conference call with LITCs (Nov. 19, 2014).

40 *See* IRS response to TAS information request (Sept. 17, 2015).

41 After an ITIN is assigned, the accompanying tax return is sent for processing and follows the same path as returns with SSNs, suggesting there may be a breakdown in the process between the time the ITIN is processed and the return is sent for processing. *Id*.

Accepting Individual Taxpayer Identification Number (ITIN) applications throughout the year would allow the IRS to apply greater scrutiny to applications where an ITIN is not needed until the filing season.

that if the income and identity cannot be validated, the return will not be processed,[42] even if the return was a valid return under the *Beard* test.[43] This practice infringed a *taxpayer's right to pay no more than the correct amount of tax* because a properly executed return can constitute a claim for refund, and if the ITIN unit failed to send the return for processing and assign an identification number, the IRS may be unable to locate the return and thus argue no claim for refund was timely filed if the RSED has passed.[44] Furthermore, the IRS's prior practice impaired a taxpayer's *right to be informed* because the IRS did not notify taxpayers that their returns were not being processed. TAS persuaded the IRS to protect these rights by revising the IRM to process tax returns with an Internal Revenue Service Number (IRSN)[45] when they are received with an ITIN application and the IRS cannot verify that the applicant has satisfied the requirements to be assigned an ITIN.[46]

Accepting ITIN applications throughout the year would allow the IRS to apply greater scrutiny to applications where an ITIN is not needed until the filing season. The IRS could prioritize those applications where an ITIN is needed immediately, such as for FATCA purposes. The IRS could prevent more fraud by having two separate opportunities to detect fraudulent income or identity theft — one at the time of the ITIN application, and again at the time of return filing. Currently, the IRS misses out on the benefit of identifying trends throughout the year and applying rules to detect later returns that are part of fraudulent schemes.

ITIN Applicants Are Subject to Unnecessary Burden and Risk Losing Their Identification Documents While the IRS Creates More Work for Itself By Not Providing Adequate Alternatives to Applicants Submitting Original Documents

Some of the most restrictive elements of the ITIN application procedures were implemented in 2012 in response to TIGTA's fraud concerns.[47] Applicants must either mail in original identification documents or copies certified by the issuing agency, use a Taxpayer Assistance Center (TAC) to certify their

42 IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Aug. 18, 2014). See also IRM 3.21.263.5.4.1, *Temporary W-7 Status and Final W-7 Status Screen* (Oct. 25, 2013); IRM 3.21.263.5.2.3.7, *Final Status Determination Used in Stripping Process* (Jan. 2, 2015); IRM 3.21.263.5.2.9. *Clerical Handling of Reject Status 98 Flagged 65 Day Purge, Reject Status 99 ITIN 0099 Report, Hard Reject 1 Letter 4939 Cases, and Form 4442* (Sept. 30, 2013).

43 For the tax return to be valid, it must: contain sufficient data to calculate a tax liability, purport to be a return, include an honest and reasonable attempt to satisfy the requirements of the tax law, and be signed under penalties of perjury. *See Beard v Commissioner*, 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

44 IRM 3.21.263.7.3, *Refund Inquiries Involving ITIN Issues* (June 29, 2015) advises employees working refund inquiries where the ITIN application was rejected to research an internal database to locate an assigned IRSN, which is an identification number that would not be assigned if the return was not forwarded for processing.

45 An IRSN is a temporary number used in place of a taxpayer identification number such as an SSN or ITIN in order to process a return. IRM, 3.21.263.4.5, *Internal Revenue Service Number (IRSN)* (Jan. 1, 2015). An IRSN is used for processing purposes only and is not a substitute for an SSN or ITIN. IRM 3.13.5.73, *When IRSNs Are Needed* (Jan. 1, 2015).

46 *See* IRS response to TAS information request (Nov. 20, 2015). The IRS revised the following IRMs: IRM 3.21.263.4.8.3, *Hard Reject Reason Codes* (Nov. 25, 2015); IRM 3.21.263.5.4.1, *Temporary W-7 Status and Final W-7 Status Screen* (Nov. 25, 2015); IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Nov. 25, 2015); IRM 3.21.263.5.2.3.7, *Final Status Determination Used in Stripping Process* (Nov. 25, 2015); IRM 3.21.263.5.10.5, *Suspense Inventory Procedures* (Nov. 25, 2015). ITIN applicants whose ITIN applications are rejected and whose returns are processed with an IRSN receive a letter notifying them that an IRSN was assigned, as well as a letter explaining that a refund cannot be released for a taxpayer using an IRSN. *See* Letter 685C, *SSN Invalid* (Rev. Oct. 2007); IRM 3.13.5.72, *Assignment of Internal Revenue Service Numbers (IRSNs)* (Apr. 3, 2015). *See also* CP 54B, *Inquiry Regarding Name and SSN - Refund Delayed* (July 2013); IRM 3.13.5.127.1, *CP 54 Notices B, E, G and Q* (Jan. 1, 2015).

47 *See* TIGTA, Ref. No, 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 16, 2012).

documents, or use a third-party certifying acceptance agent (CAA).[48] Mailing original documents is impractical for many applicants who cannot go without their original identification documents for multiple months. Furthermore, it results in some taxpayers not receiving their identification documents back. Although TAS receives cases from taxpayers trying to locate lost original documents, the ITIN unit does not track the volume of undeliverable or returned mail, the number of claims for lost documents, the success rate for finding them, or the cycle time for returning them to taxpayers.[49] Passports are especially problematic due to the need for taxpayers to have them back. In recent years, the number of original passports submitted with ITIN applications has skyrocketed, from about 55,000 in 2012, to approximately 334,000 in 2013, and approximately 390,000 in 2014.[50] From July 2014 to July 2015, the IRS returned 4,318 original passports to embassies, for which the IRS could not locate a better mailing address.[51]

The IRS is imposing a hardship on any ITIN applicant who is required to send original identification documents to the IRS and who does not have reasonable and accessible alternatives. Examples of the harm taxpayers face include a taxpayer who cannot travel abroad for a medical emergency[52] or a taxpayer who risks detention because he is unable to provide his identification documents to local law enforcement.[53] The IRM only provides for the expedited return of original documents in cases where TAS issues a request to the ITIN Unit based on the taxpayer's hardship.[54] Requiring a taxpayer to work with TAS to provide evidence of a hardship is unnecessary and a waste of time and resources because any taxpayer who is forced to give up his or her original identification documents experiences a hardship as a matter of policy. The IRS has objected to returning all original documents via expedited mail due to the additional cost, which it estimates to be in the millions of dollars.[55] However, if the IRS were to provide reasonable and accessible alternatives to sending in original documents, additional costs would be minimal due to the small number of applicants required to send their original documents to the IRS.

ITIN Authenticating TACs, which provide an alternative to giving up original documents, are a poor option for many because they can only approve two types of supporting documentation — passports and national identification cards.[56] As of September, 2015, there were 186 TACs offering ITIN authentication, with seven temporarily unavailable.[57] Some states had no TACs offering ITIN document

48 *See* IRS, IR-2012-98, *IRS Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season* (Nov. 29, 2012), *available at* http://www.irs.gov/uac/Newsroom/IRS-Strengthens-Integrity-of-ITIN-System;-Revised-Application-Procedures-in-Effect-for-Upcoming-Filing-Season. However, CAAs may not certify documents for dependents, who comprise the bulk of ITIN applicants.

49 Claims for lost identification documents are processed by the IRS Office of Chief Counsel, General Legal Services. IRS response to TAS information request (Sept. 17, 2015).

50 IRS, CDW, Form W-7 Visa Database (data drawn Oct. 20, 2015).

51 *See* IRS response to TAS information request (Sept. 17, 2015).

52 *See* National Taxpayer Advocate 2013 Annual Report to Congress 223.

53 See *id.*

54 *See* IRM 3.21.263.4.10, *Taxpayer Advocate Service (TAS) Assistance* (Oct. 19, 2015); IRM 3.21.263.5.3.4.2.4, *Returning Original Supporting Identification Documents to Applicant* (Oct. 19, 2015).

55 *See* conference call between TAS and IRS Wage and Investment, discussing *Authenticating Identification Documents at SPEC CAA VITA Sites* (Oct. 29, 2015).

56 IRS, Individual Taxpayer Identification Number (ITIN) Authenticating Taxpayer Assistance Centers, *available at* http://www.irs.gov/uac/ITIN-Authenticating-TACs-Link (last updated Dec. 7, 2015).

57 IRS, Taxpayer Assistance Center Locations Where In-Person Document Review Is Provided, *available at* http://www.irs.gov/uac/TAC-Locations-Where-In-Person-Document-Verification-is-Provided (last updated September 28, 2015).

Under the IRS's one-size-fits-all approach for Individual Taxpayer Identification Numbers (ITINs), a taxpayer trying to open a bank account abroad must meet the same arduous requirements for original documents (without the benefit of Taxpayer Assistance Centers and certifying acceptance agents) and wait just as long for an ITIN as a taxpayer claiming refundable credits, whose income and filing requirement would be subject to greater scrutiny.

authentication services,[58] and some larger states only had them located in a single metropolitan area.[59] Furthermore, taxpayers may face extreme waits at TACs, having to line up hours before they open to receive service.[60] Some taxpayers may not receive ITIN service from a TAC at all, due to reduced hours and appointment times, and limitations on how many new ITIN applications will be worked.[61] Many TACs require a valid U.S.-issued ID just to enter the building, making them completely unavailable to many applicants.[62] Qualified Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites also certify ITIN documents for free, but they have only 117 locations with CAAs, they cannot certify for dependents, and may operate only a few months each year.[63]

Using CAAs is not only cost-prohibitive for some,[64] but completely unavailable to approximately 44 percent of ITIN applicants because they cannot be used by dependents.[65] Allowing dependents to use CAAs may actually reduce fraud because CAAs often have specialized knowledge of identification documents used in certain communities and regions, and can assist the IRS in identifying fraud. Furthermore, it would save the IRS resources because applications would likely have fewer errors as a result of the CAA's expertise, thus reducing the number of applications that must be suspended and that require correspondence with the taxpayer. Increasing eligibility for CAA services would also reduce the burden on TACs, allowing them to refocus scarce resources.

In 2015, the IRS initiated a pilot to test allowing three VITA CAA sites to certify documents for dependents, limited to only passports and national I.D. cards.[66] Although the National Taxpayer Advocate is encouraged that the IRS is exploring alternative methods for dependents to have their documents certified, the pilot is structured such that its effect on applicants, and specifically on the number of applicants who submit original documents, will be minimal.

Even if the pilot is successful and leads to the IRS allowing all 128 VITA/TCE sites with CAAs to certify dependent documents, the pilot would likely only provide significant benefits to the IRS by reducing

58 Neither Montana nor Wyoming have any TACs offering ITIN certification.

59 For example, the only TACs offering ITIN services in Minnesota were in Minneapolis, St. Paul, or Bloomington, which are all part of the Minneapolis metropolitan area.

60 The IRS Commissioner expressed dismay upon hearing reports of taxpayers lining up hours before TACs opened in order to receive service during the 2015 filing season. *See Hearing before the H. Ways and Means Comm., Subcomm. on Oversight on the 2015 Tax Filing Season*, 114th Cong. (2015) (Statement of John Koskinen, IRS Commissioner).

61 One submitter to TAS's Systemic Advocacy Management System (SAMS) reported that the local TAC only gives out 12-15 tokens for new ITIN applications per day, which can only be used on weekdays and would require the submitter to pull children out of school to apply for an ITIN. SAMS Submission # 32537 (submitted March 9, 2015) (on file with TAS).

62 *See* National Taxpayer Advocate 2012 Annual Report to Congress 176. Representatives of LITCs raised concerns about the requirement of many TACs or federal buildings in which some TACs are located to produce a valid, U.S.-issued ID to enter the building. 2013 Annual LITC Grantee Conference, Recent Developments in IRS Policies and Procedures Related to ITIN Applications, panel discussion (Dec. 6, 2012).

63 *See* IRS, *List of SPEC Acceptance Agents*, *available at* http://win.web.irs.gov/spec/spec_ITIN.htm (last updated Dec. 5, 2015).

64 According to CAA websites with fee schedules posted, fees for ITINs applications prepared by CAAs can range in the hundreds of dollars for a single ITIN application.

65 IRS, CDW, Form W-7 Database for PY 2014 (data drawn Dec. 15, 2015).

66 *See* IRS, Authenticating Identification Documents for Dependents at SPEC CAA VITA Sites (Oct. 29, 2015) (on file with TAS).

the strain on TACs. While it may reduce burden for taxpayers who are already eligible to use TACs, the pilot is unlikely to decrease the number of taxpayers forced to send in original identification documents. Under the current system, dependent applicants are likely to send in original documents because either they live in a location where there is not an accessible TAC (making it unlikely there is an accessible VITA/TCE site), or they need to use documents other than a passport or national I.D. card to prove their identities. Without expanding the pilot to include all CAAs (not just VITA/TCE sites), and without allowing CAAs to approve all 13 types of documents for dependents, these applicants will still need to mail in original documents. Furthermore, because ITIN applicants in the pilot must meet the income eligibility requirements for the VITA sites, the benefits are further limited to only those taxpayers who generally make $54,000 or less, have a disability, are elderly, or have limited English.[67] Because dependent applicants are required to file ITIN applications with a tax return,[68] and generally do so during the filing season, the National Taxpayer Advocate hopes the IRS will extend the pilot through the filing season in order to obtain a full picture of how the pilot will affect dependent applicants.

In late December of 2015, Congress amended Internal Revenue Code (IRC) § 6109 to provide special rules for the issuance of ITINs.[69] The new law provides that the IRS may issue an ITIN to an applicant residing in the United States if the applicant provides the documentation required by the IRS either (a) in person to an IRS employee or to a community-based certified acceptance agent (as authorized by the IRS), or (b) by mail.[70] For applicants residing outside the United States, they must submit their applications either by mail, to an IRS employee, or to a designee of the Secretary at a U.S. diplomatic mission or consular post.[71] It allows the IRS to establish documentation requirements for ITIN applicants to prove identity, foreign status, and residency.[72] However, the IRS may only accept "original documents or certified copies meeting the requirements of the Secretary."[73] This language gives the IRS the latitude to provide a number of alternatives to accepting only original documents or copies certified by the issuing agency. When implementing the law, the IRS should use this opportunity to study the additional types of certified copies that may meet its requirements; for example, copies certified by state or other federal agencies other than the issuing agency, clerks of courts, notarized copies, and copies that are properly apostilled and authenticated by U.S. diplomatic missions abroad.[74]

Furthermore, the law provides no limitations on what documents can be certified by a CAA and whether a CAA can certify dependents' documents. Finally, the law envisions an expansion of the CAA program, which the National Taxpayer Advocate hopes the IRS will fully carry out.[75] The law lists persons eligible to be acceptance agents, which includes among others, state and local governments, federal agencies, and

67 *See* IRS, Free Tax Return Preparation for Qualifying Taxpayers, *available at* https://www.irs.gov/Individuals/Free-Tax-Return-Preparation-for-You-by-Volunteers (last updated Oct. 26, 2015).

68 *See* Form W-7, *Application for IRS Individual Taxpayer Identification Number Instructions* (Dec. 2014). The pilot was originally scheduled to run from September through December 2015. *See* IRS, Authenticating Identification Documents for Dependents at SPEC CAA VITA Sites (Oct. 29, 2015) (on file with TAS).

69 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(a) (2015) (to be codified at IRC § 6109(i)).

70 *See id.* (to be codified at IRC § 6109(i)(1)(A)).

71 *See id.* (to be codified at IRC § 6109(i)(1)(B)).

72 *See id.* (to be codified at IRC § 6109(i)(2)(A)).

73 *See id.* (to be codified at IRC § 6109(i)(2)(B)).

74 For detailed information, see U.S. Department of State, Authentications and Apostilles, *available at* http://travel.state.gov/content/travel/en/legal-considerations/judicial/authentication-of-documents/notarial-and-authentication-apostille.html (last visited on Dec. 18, 2015). *See also* Convention of 5 October 1961 Abolishing the Requirement of Legalization for Foreign Public Documents, *available at* https://www.hcch.net/en/instruments/conventions/full-text/?cid=41 (last visited Dec. 18, 2015).

75 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(c) (2015).

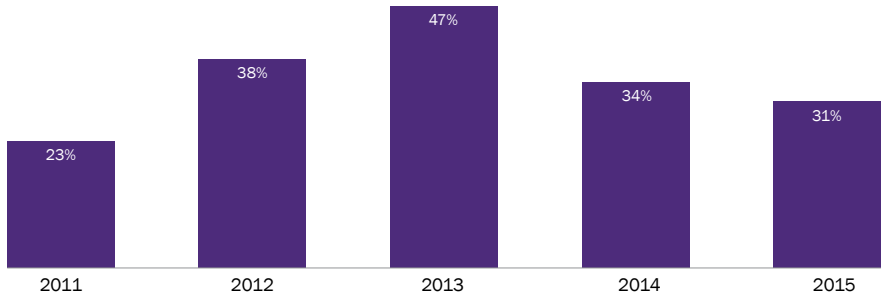
other persons or categories authorized by regulations or IRS guidance.[76] In addition, as part of a required study on the effectiveness of the application process for ITINs, the IRS must evaluate ways to expand the geographic availability of CAAs and strategies to work with other federal agencies, state and local governments, and other organizations to encourage participation in the CAA program.[77] The IRS should use the study to explore accessible alternatives to submitting original documents under its current policy. The IRS also should collaborate with TAS on developing criteria for this study, and include a TAS representative on the study team.

Combined, the Requirements for Most Applicants to Apply for an ITIN During the Filing Season and Send Original Documents May Contribute to Errors on the Parts of the ITIN Unit and Applicants, Resulting in Growing Suspension and Rejection Rates

The compressed timeline for reviewing documents during the filing season encourages errors by the ITIN unit and leads to the use of seasonal employees, who may have less experience and expertise in reviewing ITIN applications. The timeline also leads to errors by applicants who have less time to put together applications. The rate for ITINs rejections is unacceptably high, with almost a third of applications rejected during the past two years, as shown in Figure 1.18.5.

FIGURE 1.18.5[78]

Percent of Rejected ITIN Applications in PYs 2011-2015



It is likely that the original documents requirement contributed to the spike in rejections in 2013, as a result of taxpayers sending in incomplete applications or failing to meet the IRS's standards for original documents. During the last two processing years, the number one reason for suspended applications was documentation that did not meet IRS criteria as shown in Figure 1.18.6.

76 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(c) (2015).

77 *See id*. at § 203(d).

78 IRS, *ITIN Comparative Reports* (Nov. 21, 2015, Dec. 31, 2014; Dec. 29, 2012).

FIGURE 1.18.6, Top Five Reasons for Suspended ITIN Applications[79]

Suspense Codes	2014	Jan. 1 - July 31, 2015
S02 – Valid documentation (*i.e.*, didn't meet IRS criteria)	97,762	70,259
S26 – Passport	33,543	26,469
S03 – Identification documents must be an original or certified by the issuing agency	31,218	22,317
S36 – School Record	29,442	20,337
S30 – Medical Record (under 6)	28,826	19,003

A frequent practitioner complaint is the IRS's suspending or rejecting applications with legitimate supporting documents. One LITC reported that over 25 percent of its ITIN applications were either suspended or rejected outright, despite being reviewed and certified by an on-site CAA and having no errors.[80] In one case the IRS asked for a passport to be resubmitted, even though a valid passport was certified by a CAA, meaning an original passport did not need to be submitted. Although the rejection rate has improved since 2013, errors by applicants and the IRS are likely as long as most ITIN applications must be filed during the filing season and include original documents.

Taxpayers Abroad Needing ITINs for Information Reporting Purposes Are Especially Burdened by the ITIN Requirements and Procedures

As a result of the procedures, ITIN applicants abroad often must mail their documents internationally and go without them for an extended time. Taxpayers abroad do not have the benefit of TACs, which allow applicants in the United States to avoid sending in original documents. The IRS attaché offices abroad used to be able to certify ITIN applications, but all four were closed in 2015.[81] Currently, applicants abroad have limited CAA options, with CAAs in only 18 countries (Macau and Hong Kong are counted as part of China) and one U.S. territory as shown in Figure 1.18.7.[82]

79 IRS response to TAS information request (Sept. 17, 2015). Data for PY 2015 was only available for the first half of the year.

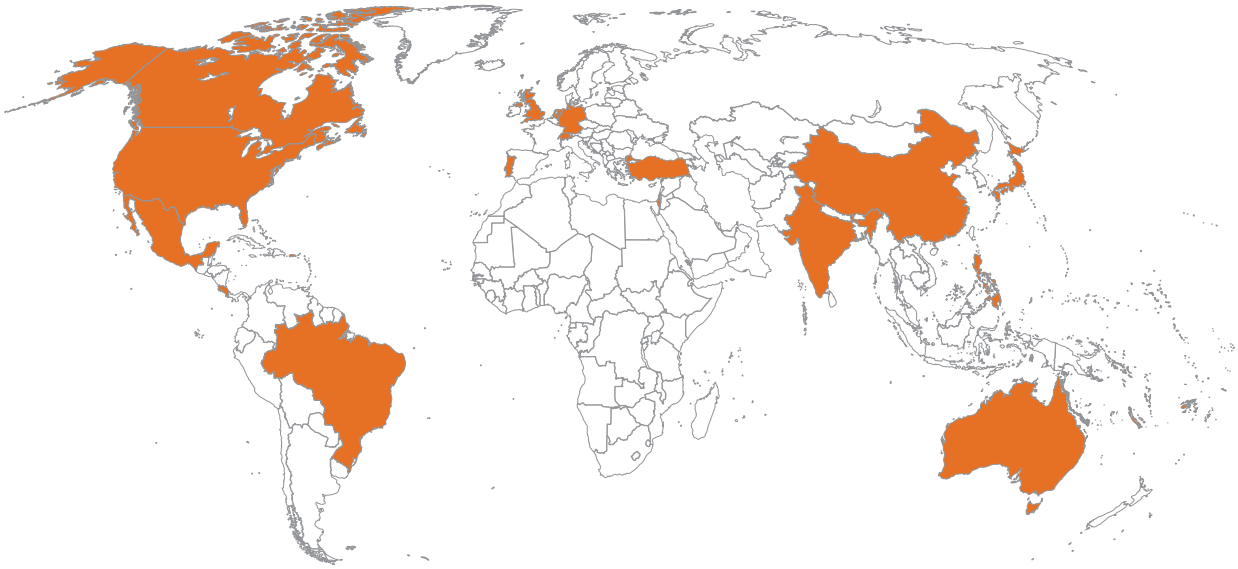
80 The Clinic reported this information on TAS's SAMS. *See* SAMS Issue # 33030 (submitted June 1, 2015) (on file with TAS).

81 *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*, *supra*.

82 The IRS has indicated that there are 18 countries (Macau and Hong Kong are counted as part of China) and one U.S. territory with a CAA. However, the irs.gov website only lists 17 countries outside the United States with CAAs because the irs.gov website is available to the general public, and only CAAs requesting to be posted on this website are listed. *See* IRS response to TAS fact check (Dec. 11, 2015). *See* IRS, *available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (last visited Nov. 23, 2015).

FIGURE 1.18.7[83]

Map of Countries with CAAs



Furthermore, some of the largest countries with CAAs only have one or two in the entire country.[84] The recently passed law amending IRC § 6109, referenced above, includes federal agencies in its list of persons eligible to be CAAs,[85] but the law also dictates that applicants residing abroad will not have the option of submitting their applications through a CAA at all because they are limited to submitting them by mail, to an IRS employee, or to a designee of the Secretary at a U.S. diplomatic mission or consular post.[86] Furthermore, the expanded program for training and approving CAAs under the new law is only for the purposes of applicants residing in the United States.[87] It is incumbent upon the IRS to provide alternatives for applicants residing abroad to provide certified copies outside of using a CAA.

The recent law authorizes the IRS to accept ITIN applications at a U.S. diplomatic mission or consular post.[88] The National Taxpayer Advocate hopes the IRS will start allowing U.S embassies and consulates abroad to certify documents in a manner similar to a CAA. Currently, there are 275 U.S. consulates and embassies that provide a similar service for SSN applicants by conducting an in-person interview, certifying original identification documents such as birth certificates and passports, and referring the

83 IRS, *available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (last visited Nov. 23, 2015). The figure only shows 17 of the 20 countries (in addition to the United States) that have CAAs because the other three countries with CAAs are those where the CAAs have not requested to be posted on the irs.gov website available to the public.

84 Brazil has only one CAA and India has only two. IRS, Acceptance Agent Program, *available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (last visited Nov. 23, 2015).

85 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(c) (2015). This section defines federal agencies according to the definition in IRC § 6402(h), which provides "the term 'Federal agency' means a department, agency, or instrumentality of the United States, and includes a Government corporation (as such term is defined in section 103 of title 5, United States Code).

86 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(a) (2015) (to be codified at IRC § 6109(i)(1)(B)).

87 *Id.*

88 *Id.*

applications with copies of the documents to a Federal Benefits Unit.[89] Thus, the Department of State could certify documents for ITIN applicants in its missions abroad following established procedures.[90]

Applicants abroad also face the same timeframe as applicants applying during the filing season, which was 11 weeks in 2015, even if they are subject to an exception such as for FIRPTA or FATCA purposes and apply for an ITIN outside the filing season.[91] Under the IRS's one-size-fits-all approach for ITINs, a taxpayer trying to open a bank account abroad must meet the same arduous requirements for original documents (without the benefit of TACs and CAAs) and wait just as long for an ITIN as a taxpayer claiming refundable credits, whose income and filing requirement would be subject to greater scrutiny. This process creates unnecessary barriers to commerce.

Future Requirements for Deactivating ITINs Will Deprive Some Taxpayers of ITINs They Need for Tax Administration Purposes, and the IRS Policy Will Undermine Taxpayers' *Right to Be Informed*

The IRS's deactivation plan will seriously infringe a taxpayer's *right to be informed* because the IRS will not provide advanced notification to taxpayers' last known address prior to deactivating their Individual Taxpayer Identification Numbers (ITINs).

The National Taxpayer Advocate has long advocated for the IRS to create a process for deactivating ITINs that are no longer used for tax administration purposes and is pleased the IRS and Congress have finally adopted her recommendation.[92] However, she has concerns about how the deactivation plan will be carried out according to the requirements of the recently passed law and the IRS's implementation plans. Under the new law, ITINs issued during 2013 and later will remain in effect unless the individual to whom the ITIN was issued fails to file a tax return or be claimed as a dependent on another's tax return during a period of three consecutive years.[93] Before this law was passed, the IRS had announced its own deactivation plan, which would deactivate ITINs after five consecutive years of non-use.[94] The National Taxpayer Advocate was concerned that the IRS refused to clarify whether ITINs included on a third-party information return would constitute use for tax purposes during the period, such that it would prevent deactivation.[95] She is equally concerned that the new law does not take into account an information return filed by a third party that lists an individual's ITIN. The deactivation requirements included in the amendment to IRC § 6109 will lead to countless problems down the road for individuals who need an ITIN in order to provide it to a third party for information reporting purposes, but who may not have a tax return filing obligation and thus would not file during a three-year period. For example, the ITIN may be used on an interest-bearing financial account, but the taxpayer's income is below the filing threshold.

89 *See* email from Department of State governmental liaison to TAS (Sept. 9, 2015) (on file with TAS); email from Social Security Administration governmental liaison to TAS (Sept. 23, 2015) (on file with TAS).

90 For detailed information, see U.S. Department of State, Authentications and Apostilles, *available at* http://travel.state.gov/content/travel/en/legal-considerations/judicial/authentication-of-documents/notarial-and-authentication-apostille.html (last visited Dec. 18, 2015). Foreign Public Documents, *available at* https://www.hcch.net/en/instruments/conventions/full-text/?cid=41 (last visited Dec. 18, 2015).

91 *See* IRM Procedural Update WI-03-0215-0352 (Feb. 19, 2015), *available at* http://www.irs.gov/pub/foia/ig/spder/WI-03-0215-0352%5b1%5d.pdf.

92 *See, e.g.*, National Taxpayer Advocate 2010 Annual Report to Congress 333; National Taxpayer Advocate 2008 Annual Report to Congress 130.

93 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(a) (2015) (to be codified at IRC § 6109(i)(3)).

94 *See* IRS, IR-2014-76, *Unused ITINS to Expire After Five Years; New Uniform Policy Eases Burden on Taxpayers, Protects ITIN Integrity* (June 30, 2014), *available at* https://www.irs.gov/uac/Newsroom/Unused-ITINS-to-Expire-After-Five-Years%3B-New-Uniform-Policy-Eases-Burden-on-Taxpayers,-Protects-ITIN-Integrity

95 *See* IRS response to TAS information request (Sept. 17, 2015).

The IRS's deactivation plan will seriously infringe a taxpayer's *right to be informed* because the IRS will not provide advanced notification to taxpayers' last known address prior to deactivating their ITINs.[96] Although the IRS will communicate information on its website and to CAAs about the deactivation plan, it will only notify taxpayers of a deactivated ITIN and provide guidance about how to reactivate it upon submission of a return and on settlement notices.[97] This shortsighted policy will undoubtedly harm taxpayers who will not learn that they need to reapply for an ITIN until after they have already filed their returns and are awaiting refunds. Taxpayers who are traveling away from a CAA or TAC, or who do not have in their possession or cannot give up their original identification documents, may be unable to reapply for ITINs and receive their refunds. If these taxpayers were notified in advance, they could plan accordingly, or challenge the deactivation if they believed it was in error. This policy will result in more work for the IRS because it will need to process the returns under IRSNs and later merge them to the taxpayers' reactivated ITINs.

CONCLUSION

The IRS continues to make it exceedingly difficult for taxpayers needing ITINs to comply with their tax filing and payment obligations. Until the IRS makes some significant changes in how applicants apply and how it processes ITIN applications, taxpayers may be further encouraged to stop filing returns or be prevented from receiving tax benefits to which they are lawfully entitled. Furthermore, barriers to commerce will only grow as more people will need ITINs to comply with FATCA.[98] Increased enforcement as a result of FATCA necessitates better ITIN procedures that encourage, not hamper, taxpayers' ability to comply with the tax laws.

96 *See* IRS response to TAS information request (Sept. 17, 2015).

97 *See id*.

98 *See* National Taxpayer Advocate FY 2016 Objectives Report to Congress 48-52 (Area of Focus: *The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*). *See also* 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*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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.
2. 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.
3. Return by expedited mail all original identification documents sent to the IRS.
4. Allow TACs to certify all types of identification documents for ITIN applicants.
5. Allow CAAs to certify all types of identification documents for dependent ITIN applicants.
6. Expand the VITA CAA pilot to include CAAs who are not VITA/TCE sites and allow them to certify all types of identification documents for all ITIN applicants.
7. Partner with the Department of State to provide certification of ITIN applications at U.S. embassies and consulates abroad.
8. Collaborate with TAS on developing criteria for the ITIN study required by law, and include a TAS representative on the study team.
9. Notify all taxpayers at their last known address at least three months prior to the deactivation of their ITINs and provide 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

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

As the Internal Revenue Code (IRC) gets more complex, taxpayers are increasingly turning to practitioners to assist them with meeting their tax obligations and to represent them in their disputes with the IRS. During the 2015 fiscal year (FY), there were over one million Forms 2848, *Power of Attorney and Declaration of Representative*, filed by practitioners on behalf of taxpayers with matters before the IRS.[2] Tax practitioners have become key IRS partners in achieving voluntary tax compliance and settling disputes.

The IRS created the Practitioner Priority Service (PPS) line to serve as the first line of contact for practitioners to resolve account related issues for their clients.[3] This line is intended to provide practitioners with improved overall consistency and quality of service while reducing wait time.[4]

However, reductions in staffing and available services on the PPS line have resulted in increased wait times and limited services for practitioners. Over the past five years, the IRS has gone from answering about 80 percent of PPS calls in FY 2011 to less than 50 percent in 2015.[5] In FY 2011, the average speed of answer (ASA) was 13.3 minutes compared to 46.6 minutes for FY 2015.[6] For a four-week period in FY 2015, the average wait time for the PPS line was in excess of one hour.[7] In contrast, the ASA for the

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Email from the IRS Centralized Authorization File unit stating the number of Forms 2848s filed for FY 2015 (Nov. 25, 2015).

3 Internal Revenue Manual (IRM) 21.3.10.1, *Practitioner Priority Service (PPS) Overview* (Oct. 1, 2015).

4 IRM 21.3.10.1, *Practitioner Priority Service (PPS) Overview* (Oct. 1, 2015).

5 IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2012). Level of Service (LOS) was 78.3 percent in FY 2011. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). LOS was 47.6 percent as of September 30, 2015.

6 IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2012). ASA was 13.3 minutes in FY 2011. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). ASA was 46.6 minutes, representing a 250 percent increase from FY 2011.

7 IRS, JOC, *Snapshot Reports: Product Line Detail* (weeks ending Aug. 15, 2015 through Sept. 5, 2015).

Accounts Management (AM) toll-free lines during FY 2015 was 30.5 minutes.[8] It is ironic to use the term "priority" for the practitioner line when a practitioner could call the general phone lines and have a shorter hold time.

The National Taxpayer Advocate is concerned that the IRS's lack of commitment to PPS increases the overall compliance burden on taxpayers, not limited to the increased cost of representation, and creates downstream costs for the IRS when practitioners are unable to timely resolve their clients' tax issues. Specifically, we have identified the following problems with the IRS's current approach to the PPS:

- The reduction of staffing results in an increased number of disconnected calls and a significant increase in wait time;
- The reduction in services on the PPS places an increased burden on practitioners that is passed to taxpayers; and
- The IRS does not collaborate with or collect suggestions from the practitioner community before making changes to the PPS.

ANALYSIS OF PROBLEM

Background

The PPS was designed to be the first point of contact with the IRS for practitioners.[9] Practitioners with questions have a designated professional support line they can call to receive guidance and answers regarding their clients' account related issues. IRS customer service representatives (CSRs) trained to handle practitioners' account questions staff the toll-free line.[10]

> Over the course of the 2015 filing season, the IRS answered only about 45 percent of practitioner calls on the Practitioner Priority Service, and the hold time averaged over 45 minutes.

When a practitioner calls the toll-free number, the call is routed to one of nine PPS locations.[11] The routing is based on an evaluation of the shortest expected wait times and whether the inquiry is regarding individual tax accounts or business accounts.[12] If a practitioner's inquiry is outside the scope of the PPS's authority to answer, the assistor will provide the practitioner with the appropriate telephone contact number for his or her inquiry.

The Reduction of PPS Staffing Results in an Increased Number of Disconnected Calls and Significant Increase in Wait Time

Practitioners rely upon IRS assistors on the PPS line to help them effectively represent their clients. The *right to retain representation* is negatively affected when the representative cannot reach the IRS in a reasonable amount of time and is unable to resolve issues with his or her clients' accounts.

8 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2015) (source of AM and Enterprise Total data). The AM ASA of 30.5 minutes is a combined figure reflecting 30 customer service lines.

9 IRM 21.3.10.1, *Practitioner Priority Service (PPS) Overview* (Oct. 1, 2015).

10 The toll-free number 1-866-860-4259 is available from 7:00 a.m. to 7:00 p.m. local time (Alaska and Hawaii follow Pacific Time) and 8:00 a.m. to 8:00 p.m. for Puerto Rico, *available at* http://www.irs.gov/Tax-Professionals/Practitioner-Priority-Service.

11 The nine locations are: Brookhaven, NY; Buffalo, NY; Memphis, TN; Nashville, TN; Philadelphia, PA; Pittsburgh, PA; Cincinnati, OH; Oakland, CA; and Ogden, UT, *available at* http://www.irs.gov/Tax-Professionals/Practitioner-Priority-Service.

12 The toll-free number when last called on October 23, 2015, listed a menu of several options to direct callers to the proper assistors.

The IRS has reduced the staffing on the PPS line from 98 employees solely devoted to the PPS in the FY 2011 filing season to 66 in the FY 2015 filing season, about a 30 percent decrease, as seen in Figure 1.19.1. At the end of FY 2015, the IRS had 140 employees staffing the PPS, 57 fewer employees than in FY 2011.[13]

FIGURE 1.19.1, Staffing Levels of Practitioner Priority Services[14]

Accounts Management PPS			
Fiscal Year	Staffing (as of 3/31) AM Direct FTEs	Staffing (as of 9/30) AM Direct FTEs	FY Total Calls Transferred Out
2011	98	197	254,073
2012	92	193	205,540
2013	99	203	211,330
2014	79	168	149,791
2015	66	140	116,174

The PPS line transferred out nearly 138,000 fewer practitioners' calls to other IRS functions in FY 2015 compared to FY 2011.[15] This transferred figure represents all PPS transfers and is not limited to transfers outside the scope of provided services. For example, the PPS line does not handle calls from the general public and those calls would be transferred out or directed to the appropriate function for resolution. Most significant for practitioners, a call would be transferred if the issue is a compliance issue and came into the PPS; it would need to be transferred to the proper compliance application.

With fewer staff dedicated to the PPS, the average hold times are lengthening.[16] Over the course of the 2015 filing season, the IRS answered only about 45 percent of practitioner calls on the PPS, and the hold time averaged over 45 minutes.[17]

13 Response to TAS research request from Wage and Investment (W&I) (Oct. 20, 2015). The 57 fewer employees was reached by the following computation, 197-140= 57.

14 Response to TAS research request from W&I (July 27, 2015). Staffing data (AM Direct FTE) pulled from ETD Half Hourly Adherence Reports (AM FTE = total ready agent ½ hours in AM PPS agent groups divided by 2 divided by 2,080). Transfer data is from the ETD Agent Transfers Report.

15 This number is derived by subtracting the FY 2015 number of calls from the FY 2011 number of calls (254,073 (FY 2011) – 116,174 (FY 2015) = 137,899). The data shows reduced resource expenditure from 2013, the resources expended were based on the planned LOS for each year which is driven by allocated funding.

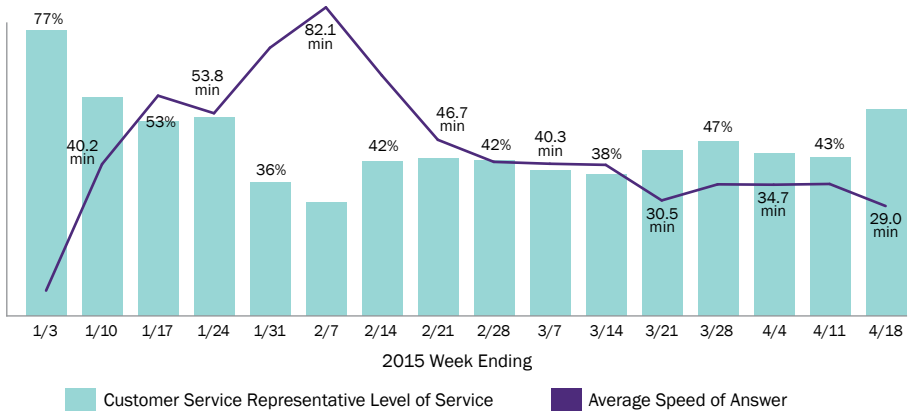
16 IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2012). ASA was 13.3 minutes in FY 2011. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). ASA was 46.6 minutes.

17 IRS, JOC, *Snapshot Reports: Product Line Detail* (Apr. 18, 2015).

FIGURE 1.19.2[18]

Filing Season 2015 Weekly Service Levels for the Practitioner Priority Service Line

This line provides tax professionals a dedicated channel to resolve taxpayer-client account issues.



While the number of attempted practitioner calls increased in FY 2015 compared to FY 2014, the percentage of answered calls decreased by more than 30 percent over the same period, from about 70 percent CSR level of service (LOS) in FY 2014 to less than 48 percent LOS in FY 2015, as shown in Figure 1.19.3. The average wait time (ASA) for the same period increased by 70 percent.[19]

FIGURE 1.19.3, FYs 2014 and 2015 Call Information for the PPS Line[20]

Fiscal Year	Dialed Attempts	Assistor Calls Answered	Level of Service	Average Speed of Answer (Minutes)	Average Speed of Answer Change
2014	1,884,497	1,148,997	70.4%	27.4	n/a
2015	2,056,376	851,716	47.6%	46.6	70%

During the summer of 2015, TAS conducted focus group interviews at the IRS Nationwide Tax Forums, which provide an opportunity for enrolled agents, CPAs, and other tax professionals to earn Continuing Professional Education credits. TAS learned that practitioners calling the PPS are experiencing such large increases in wait times that they look for other avenues for resolution of their issues.[21] During these discussions, one practitioner stated that he called into the PPS and was placed on hold. He promptly got into his car and drove to the local taxpayer assistance center, took a number, met with an assistor, got the issue resolved, and drove back to his office before being removed from hold on the PPS line.[22]

18 IRS, JOC, *Snapshot Reports: Product Line Detail* (weeks ending Jan. 3, 2015, through Apr. 18, 2015).
19 IRS, JOC, *Snapshot Reports: Product Line Detail* (Sept. 30, 2015).
20 *Id.*
21 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 8 (Nov. 2015).
22 *Id.*

Practitioners also reported extreme frustration with being placed on hold for over an hour, only to abruptly be disconnected.[23] Over 415,000 calls to the PPS were disconnected before the practitioner was even able to reach an assistor.[24] This "courtesy disconnect" occurs when the IRS switchboard is overloaded and cannot handle additional calls. The IRS allows practitioners to remain on hold on the PPS lines longer than other phone lines.[25]

Generally, practitioners bill their clients by the hour for their services and this may include any time waiting on hold to resolve issues.[26] As the wait times increase, taxpayers may pay considerably more for resolution of their tax issues. More significantly, if practitioners are unable to get through on the PPS line to resolve tax account issues, there could be serious consequences for the taxpayer. Moreover, each missed contact with practitioners to resolve account issues is a missed opportunity for the IRS to ensure that taxpayers remain compliant with their tax obligations.

> …One practitioner stated that he called into the Practitioner Priority Service and was placed on hold. He promptly got into his car and drove to the local taxpayer assistance center, took a number, met with an assistor, got the issue resolved, and drove back to his office before being removed from hold on the Practitioner Priority Service line.

The Reduction in Services on the PPS Places an Increased Burden on Practitioners That Is Passed on to Taxpayers

PPS is available for practitioners requesting assistance with a variety of tax issues including understanding IRS notices and letters, correcting processing errors, locating and applying payments, securing installment agreements, and assisting with tax account adjustments. Over the last several years, the IRS has reduced the number of services provided by the PPS which impacts both practitioners and taxpayers.[27]

Practitioners report they were previously able to call the PPS with tax law questions and resolve multiple client account issues with one call.[28] Practitioners are reporting that even when they get through to an assistor they are only able to address one client's issues at a time, rather than five as specified in the Internal Revenue Manual.[29] If a practitioner wants to address issues for additional clients, they have to hang up and call back, enduring the extensive wait time all over again.

Starting in 2014, the IRS limited the PPS scope to practitioners working on resolving their clients' active tax account issues. The IRS no longer services

23 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service*. (Nov. 2015). IRS, JOC, Custom Report RRC 1623 (including weekly data on the number of courtesy disconnects from FY 2011 through FY 2015).

24 IRS, JOC, Custom Report RRC 1623 (including weekly data on the number of courtesy disconnects from FY 2011 through FY 2015). This figure can be influenced by a number of factors including caller behavior. For example, during periods of high demand, a caller might make multiple calls to the PPS simultaneously in hopes of increasing the chance of getting through for a single issue.

25 IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). ASA was 46.6 minutes. IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2015) (source of AM and Enterprise Total data). The AM ASA of 30.5 minutes is a combined figure reflecting 30 customer service lines.

26 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 8 (Nov. 2015).

27 IRM 21.3.10.2, *Scope of Service* (Aug. 14, 2009). Through the PPS IRM of August 14, 2009, practitioners were not limited to the number of client accounts they could address per call to the PPS. As of the same IRM dated October 1, 2010, and in the current IRM, practitioners are limited to addressing five client accounts per call to the PPS.

28 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 7 (Nov. 2015).

29 *Id.*; IRM 21.3.10.2.1(2) (Sept. 16, 2015). PPS toll-free CSRs resolve inquiries by taking the appropriate action and providing an accurate response. CSRs will limit the tax practitioner to no more than five (5) clients per call. CSRs will provide complete and accurate information and advise tax practitioners to provide their clients with the appropriate toll-free non-PPS customer service number.

calls from tax practitioners or other third parties for non-tax matters, such as transcript requests for monitoring clients' financial history. Other areas that are no longer addressed by the PPS include: general tax law questions, accounts assigned to the Automated Collection System (ACS), Automated Under Reporter (AUR) cases, Automated Correspondence Examination (ACE) situations, or when a case is assigned a Revenue Officer or Revenue Agent. [30]

FIGURE 1.19.4, Scope of Practitioner Priority Services

Services Provided by PPS	Services Not Provided by PPS
Understanding IRS's notices and letters	Answers to tax law questions
Correcting processing errors	Assistance with accounts assigned to Automated Collection System
Locating and applying payments	Assistance with accounts assigned to Automated Under Reporter
Requesting installment agreements	Accounts assigned to Correspondence Examination
Requesting tax account adjustments	Accounts assigned to a Revenue Officer or Revenue Agent

Instead, these types of calls are transferred or referred to other IRS functions. When practitioners call the PPS about customer accounts that are being handled by the ACS unit, the practitioner is transferred to the respective compliance area, resulting in additional wait time and risk of being disconnected before assistance can be offered. Litigation demonstrates that taxpayers are more likely to prevail against the IRS when represented by a tax professional.[31] By reducing practitioners' ability to timely reach the IRS, they are likely impacting taxpayers' ability to satisfactorily resolve their case.

Finally, as the IRS continues to reduce taxpayer services for the general taxpayer population, it drives that work, such as answering complex tax law questions, to practitioners.[32] This shifting of more responsibility to practitioners to resolve taxpayer issues means it is more critical than ever that the PPS provide the services practitioners need to resolve them.

The IRS Does Not Collaborate With or Solicit Suggestions From the Practitioner Community Before Reducing the Scope of the PPS

During FY 2013, an internal IRS review of the PPS revealed that the customer base of the PPS had expanded from practitioners working on actual account issues to include businesses providing third-party tax account monitoring services.[33] These services included monthly monitoring and compliance checks of current and potential clients via monthly calls to the PPS requesting verbal account information and multiple transcripts. Based upon this review, the IRS elected to restrict access to PPS so that only practi-

30 The ACS is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies. The AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payers reported via W-2, Form 1099, and other information returns. ACEs are automated from the initiation, aging and closing of certain Earned Income Tax Credit (EITC) and non-EITC cases. Using the ACE, Correspondence Exam can process specified cases with minimal to no tax examiner involvement until a taxpayer reply is received.

31 *See* Most Litigated Issues, *infra*. *See also* National Taxpayer Advocate 2014 Annual Report to Congress 426 (Most Litigated Issues).

32 R-Mail was originally deployed as a tool to send referrals to complex tax law questions that would require research by more experienced assistors. The IRS is no longer answering complex tax law questions. SERP Alert 15A0442, *Post R-Mail Guidance* (Oct. 5, 2015). *See also* Most Serious Problem: *Compliance Capabilities Vision*, *infra/supra*.

33 W&I response to TAS information request (July 27, 2015).

tioners who provide tax advice, prepare income taxes or act on behalf of taxpayers with regards to active account related issues will be assisted. These changes were included in the implementation of the 2014 Service Approach.

Now the IRS directs non-practitioners to use the Income Verification Express System or the Form 4506-T to secure account information. While this change reduced the burden placed upon the PPS by eliminating a subset of calls, the IRS neglected to reach out to practitioners to discuss the change and solicit what other types of changes could be beneficial for practitioners.

Practitioners participating in the National Taxpayer Advocate Tax Forums focus groups overwhelmingly stated that the PPS is worse than it was five years ago and that none of them have noticed any improvements to service on the line.[34] Despite the overall lack of service and satisfaction with the PPS, the majority of practitioners would like to continue using the line as a resource when encountering tax issues.[35] Suggestions on how to improve the line from practitioners include: giving the caller the option to be disconnected prior to receiving a courtesy disconnect; leaving a phone number for an assistor to call back rather than having practitioners wait on hold; using more detailed prompt questions; offering a specific dedicated phone number for transcript requests; and having knowledgeable assistors who have the authority to correct issues and solve problems.

For a number of years, the National Taxpayer Advocate has recommended that the IRS develop online services for taxpayers and practitioners.[36] Online account access was recently listed as one of the top ten initiatives needed to achieve the IRS's compliance vision.[37] As the IRS begins to evaluate how to move towards a more interactive format of online account access allowing taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates, specific attention should be paid to incorporating the needs of the practitioner community while protecting taxpayers.[38]

Even with the onset of increased online account services, it will not replace the need for the PPS.[39] Practitioners need to have an avenue by which they can discuss tax account issues with a live IRS employee and seek resolution and clarification on how to solve outstanding problems. Access to accounts online will help practitioners identify and isolate the problem, but will not always allow for solving of the account issues. Thus, the IRS should consult with practitioners, via their membership bodies and focus groups at the Tax Forums and other annual meetings of tax professionals, about what services the PPS should provide when an online account is available.

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34 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 6 (Nov. 2015).

35 *Id*. at 8.

36 *See, e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

37 Draft IRS Compliance Concept of Operations (CONOPS) 3, 19-22 (June 2014).

38 See 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, supra; 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, supra; 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, supra.*

39 *Id*.

CONCLUSION

As originally intended, PPS was a useful tool for practitioners that facilitated fast resolution of their clients' tax issues. The limitations in the scope of provided services combined with increased hold time have eroded its usefulness. Practitioners calling the PPS line spend more time on hold, have a lower chance of getting through to a live IRS CSR and use the PPS for fewer services than in previous years.[40] The IRS's lack of commitment to either restore the full suite of services originally available or offer a viable alternative for practitioners erodes several taxpayer rights, including *the right to quality service*, *the right to challenge the IRS's position and be hard*, *the right to retain representation*, *the right to pay no more than the correct amount of tax*, and *the right to a fair and just tax system*. Failure to promptly address practitioner access to the IRS results in increased cost of representation to taxpayers and downstream costs, as well as exposing the IRS to a possible increase in litigation over those unresolved issues.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Restore staffing levels to FY 2011 levels on the PPS to decrease wait time and eliminate disconnects for the practitioners.
2. Allow the resolution of complex tax law issues by asking questions and receiving answers from assistors.
3. Allow practitioners to resolve as many as five client account issues during one call as stated in the IRM.
4. Consult with and survey the practitioner community to find out their needs and preferences before making changes to the PPS.
5. Retain the PPS even as online account systems are developed to assist practitioners with account issues that cannot be solved through online channels, and consult with practitioners about the design of a post-online account PPS.

40 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* (Nov. 2015).

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

RESPONSIBLE OFFICIALS

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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

IRS guidance instructs revenue officers (ROs) to designate every payment they receive from a taxpayer with a specific code.[2] ROs 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).[3] Congress has mandated such accounting for all federal payments.[4]

As discussed previously in the National Taxpayer Advocate's 2009 Annual Report to Congress, the IRS is not consistently or accurately applying DPCs, which reduces the IRS's ability to assess the effectiveness of its collection actions.[5] In calendar year (CY) 2014, 87 percent of payments either had no DPC or defaulted to DPCs of "00" (undesignated payment) or "99" (miscellaneous).[6] A 2012 Treasury Inspector General for Tax Administration (TIGTA) report raised similar concerns. Specifically, the report showed that 77 percent of payments reviewed were processed without the required DPC, including payments received after a Notice of Federal Tax Lien (NFTL) was filed.[7] Additionally, 34 percent of payments that did have a DPC placed on the payment had an incorrect DPC.[8] A recent IRS study also found that

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Internal Revenue Manual (IRM) 5.1.2.8.1, *Designated Payment Codes* (Sept. 26, 2014).

3 IRM 5.1.2.8.1, *Designated Payment Codes* (Sept. 26, 2014).

4 *See generally* 31 U.S.C.A. §§ 3512, 3513; 31 U.S.C.A. § 3302(e).

5 National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*).

6 IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction History Table, Major Transaction Codes, Transaction File Cycle 201508, Transaction Dates from Jan. 1 to Dec. 31, 2014.

7 TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

8 *Id*.

certain DPCs were too vague to be helpful, that IRS DPC guidance is inconsistent, and that an absence of a systemic review of DPCs impedes the IRS's ability to obtain useful information.[9]

Adopting a consistent and accurate use of Designated Payment Codes (DPCs) would better ensure that attempts to collect an outstanding tax are useful, effective, and do not compromise a taxpayer's *right to a fair and just tax system* by taking actions that financially harm the taxpayer and have little chance of yielding the desired result.

The input of DPCs provides a way to track taxpayer behavior and future compliance but is ineffective when the IRS does not consistently or accurately apply the codes to all subsequent payments. Such failure prevents the IRS from measuring what actions, including processes such as the notice stream and the filing of an 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).

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 rather than adopt an approach that increases collection effectiveness and minimizes harm to the taxpayer. Adopting a consistent and accurate use of DPCs would better ensure that attempts to collect an outstanding tax are useful, effective, and do not compromise a taxpayer's *right to a fair and just tax system* by taking actions that financially harm the taxpayer and have little chance of yielding the desired result.

ANALYSIS OF PROBLEM

Background

The IRS receives taxpayer payments for several reasons and through various methods. For example, some payments are voluntary, such as payments submitted with a timely filed tax return. Other payments are submitted in response to IRS activities, such as receipt of an IRS notice or the filing of a lien, when the taxpayer has a balance due account. The IRS established two-digit DPCs to identify the event (*e.g.*, lien, levy, seizure) that was primarily responsible for the subsequent payment.[10] The DPCs are applied at the time the subsequent payment is processed.[11]

Congress has mandated using payment codes and tracking on a national basis to determine the revenue effectiveness of specific collection activities.[12] Congress's mandate to use such codes was largely designed to ensure that agencies having custody of public money kept accurate records of amounts received,

9 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012). This report was conducted in response to concerns expressed by the National Taxpayer Advocate and TIGTA. *See* National Taxpayer Advocate 2010 Annual Report to Congress 250-66; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. *See also* TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

10 These are generally balance due payments. Other payments, such as Estimated Tax Payments, Federal Tax Deposits, and payments with filed returns are designated by the nature of the payment, whether received in paper or electronic form.

11 *See* IRM 5.1.2.8.1, *Designated Payment Codes* (Sept. 26, 2014). *See also* IRM 3.11.10.5.10, *Designated Payment Code* (Jan. 1, 2015); IRM 21.3.4.7.1.3, *Designated Payment Code* (Oct. 1, 2014).

12 *See generally* 31 U.S.C.A. §§ 3512, 3513; 31 U.S.C.A. § 3302(e).

transferred, and paid, and to provide the President, Congress, and the public annual updates on the financial condition of the United States government.[13]

A DPC serves a three-fold purpose. The code:

- Facilitates identification of payments designated to trust fund or non-trust fund employment taxes;
- Indicates application to a specific liability when a civil penalty includes a Trust Fund Recovery Penalty and other penalties; and
- Identifies the event that resulted in payment.

The IRS requires ROs to assign the appropriate DPC to subsequent payments on the payment voucher documents Form 809, *Receipt for Payment of Taxes*, and Form 3244, *Payment Posting Voucher*. These forms are then forwarded to an IRS submission processing center, where the payment is applied to the taxpayer's balance due account. Although IRS procedures require employees to code the sources of payments received when certain transaction codes (TCs) apply, the use of DPCs is not mandatory in all other situations.[14]

The Lack of Specific and Consistent Guidance on How DPCs Are Applied Throughout the IRS Reduces the Reliability and Usefulness of the DPC Data

Accurate DPCs are important for drawing meaningful conclusions about the effectiveness of IRS activities and making data-driven policy decisions about service, enforcement, and resource allocation. Currently, the majority of DPCs are input manually, which make the DPCs subject to human error.[15] This manual selection process is open to interpretation and may result in unreliable data and may account, in part, for the high percentage of DPCs that are either undesignated payments or miscellaneous. For instance, in CY 2014, 87 percent of payments either had no DPC or defaulted to DPCs of "00" (undesignated payment) or "99" (miscellaneous).[16] A 2012 TIGTA report showed that 106 (77 percent) of the 138 subsequent payments reviewed were processed without the required DPC. In addition, 11 (34 percent) of the 32 subsequent payments that had a DPC were not accurate.[17] Employees may resort to DPC 00 or 99, or inputting no DPC at all, because they cannot identify a DPC specific enough to match the payment.

The DPC 06 is an example of a DPC that is not specific and may lead to inaccurate coding of a payment. The IRM 3.11.10.5.10 states that the DPC 06 is to be used to identify proceeds received from a "seizure or sale." The failure to provide a more specific definition of DPC 06 may result in the mislabeling of a payment. For instance, an employee may think that the DPC is only appropriate to use for property that is seized and sold, but not for seized cash. This may ultimately result in the employee inputting a DPC 00 or 99, or no DPC at all.

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13 *Id.*

14 IRM 5.1.2.8, *Designated Payment Codes* (June 20, 2013); IRM 3.11.10.5.10, *Designated Payment Code* (Jan. 1, 2015); IRM 21.3.4.7.1.3, *Designated Payment Code* (Oct. 1, 2014). The use of a DPC on all posting documents/vouchers is mandatory when the following TCs are involved: "640" Advance Payment of Determined Deficiency or Underreporter Proposal; "670" Subsequent Payment; "680" Designated Payment of Interest; "690" Designated Payment of Penalty; "694" Designated Payment of Fees and Collection costs; and "700" Credit Applied. For other TCs (*e.g.*, "610" Remittance with Return; "611" Dishonored Remittance with Return; "612" Correction of TC 610 Processed in Error; "641" Dishonored Advance Payment), DPCs are not required. TCs are numeric codes for all system actions on the IRS Integrated Data Retrieval System (IDRS). IRS, Document 6209, *IRS Processing Codes and Information* (2010), 8-1 - 8-42.

15 Manually-input DPCs are determined using the source document that accompanies the payment. The source document may be the tax return, taxpayer letter, taxpayer correspondence, or a posting voucher.

16 IRS, CDW, IMF Transaction History Table, Major Transaction Codes, Transaction File Cycle 201508, Transaction Dates from Jan. 1 to Dec. 31, 2014.

17 TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

Additionally, IRS guidance on when to use a particular DPC is insufficient, resulting in inconsistent and inaccurate determinations. For example, the definition of DPC 99 is both inconsistent and vague in the Collection (Part 5), Submission Processing (Part 3), and Accounts Management (Part 21) IRM sections. Definitions vary from:

- Miscellaneous payment (do not use if another DPC Code is applicable);[18]
- Miscellaneous payment other than above;[19]
- Miscellaneous;[20] and
- Miscellaneous payment other than 01 through 14.[21]

The IRS should develop consistent guidance throughout the IRM as to when IRS employees should use DPC 99, rather than having different instructions for employees working in different divisions in the IRS. The lack of specificity and consistency in how DPCs are applied reduces the reliability and usefulness of the DPC data.

Transitioning From Mostly Manual to Systemic Input of DPCs Would Allow Regular Reviews and Improve Accuracy

Accurate Designated Payment Codes (DPCs) are important for drawing meaningful conclusions about the effectiveness of IRS activities and making data-driven policy decisions about service, enforcement, and resource allocation.

Regular review of DPCs is important for verifying the input. However, two-thirds of all DPCs, or about 69 percent, are input manually and only 23 percent of DPCs are input systemically and are subject to review.[22] Thus, the majority of DPCs are not routinely reviewed. As discussed above, the reliability of manually-entered DPCs is questionable. Because of this unreliability, DPC information is often not taken into consideration when evaluating the effectiveness of IRS activities that supposedly led to a payment. Increasing the systemic input of DPCs may reduce errors and improve the integrity of the DPC data, simultaneously enhancing the reliability of DPC information for determining the effectiveness of specific IRS enforcement or taxpayer service activities.

Several state revenue departments use a systemic input method. These states have noticed considerable improvement in the accuracy of payment codes. The State of New York has developed a series of analytic measures that capture systemic payment data that allows for determining the best collection stream for taxpayer accounts.[23] Additionally, New York uses the codes that are input systemically to distinguish between a wage levy and a bank levy, and uses this information for determining which is more effective. The analysis of systemically input payment data showed a significantly higher case resolution rate for wage levies compared to bank levies.[24] Transitioning from a manual input of a majority of DPCs to a mainly systemic DPC process would increase the accuracy of payment data and would allow meaningful analysis of IRS activities that led to a payment.

18 IRM 5.1.2.8.1.3.1.1(1), *Examples – Using DPCs* (Aug. 15, 2008).

19 IRM Exhibit 21.1.7-5, *Designated Payment Code (DPC)* (July 17, 2014); IRM 3.11.10.5.10(8), *Designated Payment Code* (Jan. 1, 2015); IRM 3.12.10.3.23(3), *Field 01DPC – Designated Payment Code (DPC)* (Jan. 1, 2015); Exhibit 3.17.278-1, DPC Codes (Oct. 1, 2014).

20 IRM 21.3.4.7.1.3(2), *Designated Payment Code (DPC)* (Oct. 1, 2014).

21 IRM 3.8.45.9.1(3), *Designated Payment Codes (DPCs)* (Nov. 13, 2014).

22 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012). No DPC was used at all for eight percent of the payments reviewed in this report.

23 IRS, *Designated Payment Code Review Report* (Mar. 11, 2013). *See also* Memorandum from Alan Gilds, IRS Senior Program Analyst for Field Operations, Review, and Enforcement, to New York Department of Revenue (May 14, 2014).

24 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012).

Even if the IRS is unable to immediately transition to a systemic process for the input of all DPCs, it should require regular reviews to verify that manually-input DPCs are correct. These regular reviews would also identify common errors that the IRS can address through additional guidance to employees.

The input of a Designated Payment Code provides a way to track taxpayer behavior and future compliance but is ineffective when the IRS does not consistently or accurately apply the codes to all subsequent payments. Such failure prevents the IRS from measuring what actions… 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.

Implementing IRS DPC Study Recommendations is a Good Starting Point to Improve DPC Input Accuracy and Reliability

The IRS has acknowledged some of the problems discussed above in a recent report that was conducted in response to concerns expressed by the National Taxpayer Advocate and TIGTA.[25] This study made a number of recommendations, which were presented to an IRS review implementation team and the Director of Collection Policy.[26] On March 11, 2013, the DPC review implementation team and the Director of Collection Policy finalized which recommendations would be implemented and which would not.[27] The most significant findings and recommendations include the following:

1. Consider using two DPCs to distinguish between wage levies and non-wage levies and use a systemic timing approach rather than manual input;
2. Multiple DPCs can apply to one type of payment. This requires a systemic or manual determination to use one DPC rather than another. DPCs should be reviewed to ensure that they are specific enough that they can only be applied to one payment situation; and
3. DPC analysis program owners should conduct periodic accuracy reviews of the DPC selection criteria.[28]

The IRS refused to adopt these recommendations primarily because of a lack of resources. The first recommendation listed above was rejected by the DPC implementation team and the Director of Collection Policy, because it determined that creating two separate DPCs, one for wage levies and one for non-wage

25 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012). *See* National Taxpayer Advocate 2010 Annual Report to Congress 250-66 (Most Serious Problem: *The IRS Should Accurately Track Sources of Balance Due Payments to Determine the Revenue Effectiveness of Its Enforcement Activities and Service Initiatives*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*). *See also* TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

26 IRS response to TAS information request (Sept. 1, 2015).

27 *Id*.

28 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012).

levies, would only be feasible if a systemic approach could be used rather than inputting the codes manually.[29] The explanation of this determination went on to say that the manual input of these two different DPCs would have to be reviewed manually, which would be time-consuming, and the IRS currently does not have enough resources to devote to such a review. The only other alternative would be to adopt a systemic approach, which the review team and the Director of Collection Policy deemed too costly.[30] The remaining two recommendations were also rejected because they were too costly.[31] They would both depend on the IRS adopting a systemic approach to DPCs rather than its current manual input approach.

The decision to reject these recommendations on the basis of a lack of resources was never shared with the IRS Commissioner, Deputy Commissioner for Services and Enforcement, or the National Taxpayer Advocate. Failing to adopt these recommendations because of resources is shortsighted and inexcusable, perpetuating the IRS's conduct of collection actions in a vacuum. Improving the accuracy and reliability of the DPCs can lead to the most efficient use of IRS resources based on knowing what IRS activities most likely resulted in a payment from the taxpayer. Moreover, a collection strategy based on ignorance and guesswork increases the risk of taking collection actions that are more intrusive than necessary, thereby undermining taxpayer trust in the system and undermining taxpayers' *right to privacy*.

CONCLUSION

The IRS is not consistently or accurately applying DPCs, which reduces its ability to assess the effectiveness of collection actions and service initiatives. Without accurately coding all the payments it receives, the IRS cannot fully meet its legal requirements to measure its business results.[32] It also cannot meet its strategic objective of developing a data-driven approach to allocating resources and making effective service, enforcement, and resource allocation decisions.[33] Finally, internal and external stakeholders are unable to accurately assess the effectiveness of IRS enforcement activities and service initiatives.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise IRM guidance and guidelines for lockbox receipts to require the entry of specific DPCs on all balance due payments.
2. Require Submission Processing employees to verify the presence of an appropriate DPC on payments by conducting regular quality reviews.
3. Provide clear and specific guidance about the circumstances under which employees can use a miscellaneous DPC.
4. Implement systemic input of most payment codes.

29 IRS response to TAS information request (Sept. 1, 2015).

30 *Id.*

31 *Id.*

32 *See, e.g.*, Treas. Reg. § 801.6(d)(1).

33 IRS Strategic Plan 2014-2017, *available at* http://core.publish.no.irs.gov/pubs/pdf/p3744–2014-06-00.pdf. *See also* U.S. Department of Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* (July 8, 2009), Component 2: *Make a Multiyear Commitment to Research*, *available at* http://www.irs.gov/pub/newsroom/tax_gap_report_-final_version.pdf.

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

RESPONSIBLE OFFICIAL

Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF 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)[2] and the Exempt Organizations Select Check (EO Select Check).[3] When an organization fails to file an information return or notice for three consecutive years, its exempt status is automatically revoked.[4] Shortly after this automatic revocation, which can sometimes be erroneous, the IRS removes the EO from its online-published lists of EOs and lists it as one whose exempt status was automatically revoked.

Unless the automatic revocation was due to IRS error, an automatically revoked organization must submit a new application to have its exempt status reinstated.[5] Even if the IRS promptly reinstates the organization or discovers its error, IRS databases will not immediately reflect the organization's restored exempt status. The IRS updates its databases only monthly, on the second Monday of every month, except in January when the databases are not updated at all. As a result, EOs reinstated (as well as those that receive initial exemption approval) in mid-to-late December will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising season. Reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status. The number of automatic revocation reinstatement cases during this gap period exceeded 2,500

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The EO BMF, *available at* http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Business-Master-File-Extract-EO-BMF, contains information about EOs such as the organization's employer identification number (EIN), name and address, the Internal Revenue Code (IRC) § 501(c) subsection under which it is exempt, whether contributions to it are tax deductible, whether it is a private foundation or a public charity (and the type of public charity), the month and year it received its exemption ruling, and information from its Form 990 series return. *See* Exempt Organizations Business Master File Extract (EO BMF), *available at* http://www.irs.gov/pub/irs-soi/eo_info.pdf.

3 EO Select Check is an online search tool, *available at* http://apps.irs.gov/app/eos/, that allows users to search for organizations eligible to receive tax deductible contributions (Publication 78 data), organizations whose tax exemption has been automatically revoked for not filing a Form 990-series return or notice for three consecutive years (Auto-Revocation List), and organizations that have filed a Form 990-N (also called an e-Postcard), an annual notice required to be filed by small EOs. Unless otherwise indicated, we use "EO Select Check" to refer to the capability to determine whether an organization is eligible to receive tax deductible contributions (Publication 78 data). *See* Internal Revenue Manual (IRM) 25.7.6.1, *Overview* (Jan. 1, 2015).

4 *See* IRC § 6033(j)(1) (requiring the IRS to publish and maintain a list of automatically revoked organizations).

5 *See* IRC § 6033(j)(2).

in both fiscal years (FYs) 2014 and 2015, and more than 70 percent of these cases were IRC § 501(c)(3) organizations.[6]

ANALYSIS OF PROBLEM

Background

Potential Donors and Grantors Rely on IRS Online Databases to Verify Exempt Status

The National Taxpayer Advocate has repeatedly raised concerns about IRS delays in updating its public databases relied upon by potential donors and grantors.[7] These databases, EO BMF and EO Select Check, are of critical importance for two reasons. First, they allow potential individual donors to verify before making a donation that their contributions will be tax deductible.[8] Second, they allow private foundations to verify that they are making a grant to a qualifying public charity.[9]

As a result, Exempt Organizations (EOs) reinstated (as well as those that receive initial exemption approval) in mid-to-late December will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising season. Reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status.

IRS guidance provides that grantors and contributors may rely on an organization's listing on EO Select Check or EO BMF.[10] In addition, grantors and contributors may, in some situations, rely on EO BMF information provided by a third party.[11]

One well-known third-party provider of EO Select Check and EO BMF data is GuideStar.[12] GuideStar's website contains free and subscription content. One feature available to GuideStar subscribers is Charity Check, which allows potential donors or grantors to conduct due diligence by obtaining a report that contains both EO Select Check and EO BMF data.[13] The report will also note if an organization has been automatically revoked.[14]

In FAQs on its website regarding due diligence and its Charity Check reports, GuideStar makes clear that it does not modify any IRS data, including data from EO Select Check, EO BMF, or the automatic revocation list.[15] In one FAQ regarding potential grantees whose organization does not appear in the EO BMF section of the Charity Check report,

6 TE/GE response to TAS research request (July 31, 2015).

7 *See* National Taxpayer Advocate FY 2015 Objectives Report to Congress 59; National Taxpayer Advocate 2012 Annual Report to Congress 199-200 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*).

8 A charitable contribution deduction is allowed for donations to organizations described in IRC § 170(c). These are most commonly IRC § 501(c)(3) organizations.

9 Private foundations prefer making grants to qualifying IRC § 501(c)(3) public charities over other organizations as doing so relieves them of certain oversight requirements (called expenditure responsibility) that would otherwise arise and eliminates the risk of incurring liability for an excise tax under IRC § 4945.

10 *See* Rev. Proc. 2011-33, 2011-25 I.R.B. 887.

11 *Id.*

12 *See* www.guidestar.org. GuideStar is an IRC § 501(c)(3) public charity that provides information and reports about nonprofit organizations registered with the IRS.

13 For a sample Charity Check report, see http://www.guidestar.org/downloadable-files/sample-guidestar-charity-check-report.pdf.

14 *See FAQs: Due Diligence and GuideStar Charity Check Overview*, FAQ #15, *available at* http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx.

15 *See FAQs: Due Diligence and GuideStar Charity Check Overview*, FAQs #16 and #17, *available at* http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx.

GuideStar advises these organizations to "work directly with the IRS to ensure that their information is updated and accurately reflected in the IRS database."[16] Understandably, GuideStar emphasizes that it "cannot and will not modify the IRS BMF database in any way" and directs these organizations to contact the IRS EO toll-free number.[17] Thus, GuideStar (or any third-party) data is only as good as the source data from the IRS's online databases.

Other organizations highlight the importance of the EO Select Check and EO BMF databases to potential donors and grantors that are conducting due diligence and vetting organizations. For example, the Council on Foundations, a nonprofit leadership association of grantmaking foundations and corporations, has information on its website advising grantmakers of the EO Select Check search tool and referencing the EO BMF.[18] Another organization, Grants Managers Network, advises grantors that are conducting due diligence and vetting potential grantees that "the best practice, if you have doubts about a potential grantee's tax status, is to check it online using the IRS's free Exempt Organizations search or a third-party source."[19]

Finally, a grantmaking foundation may require potential grantees to be listed on the EO BMF. For example, one private foundation's website explains in great detail the nature of the EO BMF and requires potential grantees to have an accurate EO BMF listing.[20]

The IRS Recognizes the Reliance of the Public and Potential Grantors on Its Online Databases Yet It Fails to Update Them Timely

The IRS Recognizes Reliance on the Information Contained in Its Online Databases

The Internal Revenue Manual (IRM) discussing EO Select Check notes:

> The exempt organization (EO) community has become increasingly dependent upon their listings in the CL [EO Select Check] to prove to potential contributors that contributions to them are deductible. The fact that an organization may hold a favorable determination letter is often not sufficient to satisfy some contributors, especially in those cases where the Service issued an organization's letter many years ago.[21]

Similarly, a Tax Exempt/Government Entities (TE/GE) IRM section discussing the EO BMF notes that "many grantors rely on the information contained in the online EO BMF to determine the eligibility of

16 *See FAQs: Due Diligence and GuideStar Charity Check Overview*, FAQ #17, *available at* http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx.

17 *Id*. This number is 877-829-5500.

18 *See* Council on Foundations, *IRS Search Tool: Select Check*, *available at* http://www.cof.org/content/irs-search-tool-select-check.

19 *See Project Streamline: Guide to Due Diligence*, p. 6, *available at* http://gmnetwork.org/wp-content/uploads/2014/07/Due-Diligence.pdf. This document discusses five myths about due diligence. Myth #3 is that grantmakers need to have a copy of a grant seeker's IRS determination letter and Form 990 in every file. The document provides that a copy of the IRS determination letter only indicates that the grantee was tax-exempt at a certain point in time and the original determination may have been rescinded or modified. Therefore, grantors should verify a potential grantee's tax status online with the IRS or a third-party source. Grants Managers Network is a national association of philanthropy professionals.

20 *See* Mathile Family Foundation, *FAQs – Tax Information*, *available at* http://www.mathilefamilyfoundation.org/grantmaking/faqs/tax-information/. These FAQs discuss in great detail the grantmaking restrictions on private foundations and the severe penalties that the foundation and its managers are subject to if these rules are violated. The FAQs also advise potential grantees to **"make sure that the IRS BMF code *currently* represents your non-profit activities/operation (Form 990) and aligns with your Form 1023 filings and subsequent communications as approved by the IRS. When these separate designations do not agree, your organization is required to rectify discrepancies with IRS. Please consult with your tax advisor."** (bold and italic emphasis in original).

21 IRM 25.7.6.1(3) (Jan. 1, 2015). The same language is also used in IRM 21.3.8.12.12(3) (June 18, 2012).

their applicants."[22] Yet in the same IRM section the IRS disavows responsibility if an organization loses a grant due to not being included in the EO BMF, noting:

> The IRS cannot control how grantors and contributors use these data. It is not Service error if an organization fails to receive a grant because it is not included in the online EO [B]MF, or because some of the information contained therein is out-of-date. Possession of a valid determination letter is the ultimate legal proof of tax-exempt status.[23]

Despite Recognition of the Reliance on Its Online Databases, the IRS Fails to Timely Update Them, Causing Harm to EOs and Their Contributors

Although the IRS recognizes that a listing on its online databases can be critical for an EO, it does not update these databases in a timely manner, causing reinstated automatically revoked organizations (as well as those organizations receiving exempt status for the first time) to potentially lose out on donations or grants.[24] Currently, EO Select Check and EO BMF are only updated monthly, on the second Monday of every month.[25] An organization that misses the updating cutoff will not appear on the IRS lists until the next month. In addition, these databases are not updated at all during the month of January, meaning there is a two-month updating gap from the second Monday in December until the second Monday in February.[26] As a result, new and reinstated EOs that receive IRS approval of exemption after the early December cutoff will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising push. The number of automatic revocation reinstatement cases during this gap period ranged from 1,353 to 2,792 in FYs 2012 to 2015, exceeding 2,500 in both FYs 2014 and 2015, as shown in Figure 1.21.1. Significantly, more than 70 percent of these cases from the last two fiscal years are IRC § 501(c)(3) organizations.

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22 IRM 21.3.8.12.13(3) (Nov. 16, 2012).

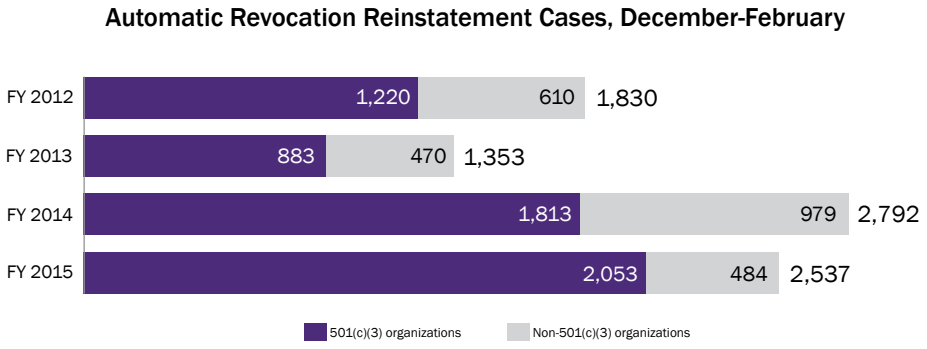
23 *Id*.

24 This delay may also affect newly-recognized tax EOs that receive a determination letter but are not promptly listed on the online databases. However, the harm to reinstated automatically revoked organizations is arguably greater as these organizations were formerly tax exempt and had the ability to receive tax-deductible contributions.

25 IRM 21.3.8.3.8(1)(f) (Oct. 1, 2015) (noting "online Publication 78 data is generally updated the second Monday of each month"); IRM 21.3.8.12.13(2) (Nov. 16, 2012) (noting that EO BMF is updated or extracted monthly). The term "extracted" is used because, as mentioned earlier, the EO BMF is an extract of information regarding EO accounts from the larger Business Master File (BMF). *See* IRM 25.7.5.1(1) (Jan. 1, 2015). In response to a TAS information request, the IRS stated that the internal IRS EO BMF list is generally updated within two weeks of a favorable case closing. The IRS also stated that the program that produces the online EO BMF and EO Select Check extracts is run approximately the last full week of each month and posted online to irs.gov the second Monday of the following month. Any accounts that are updated and posted prior to the running of the extract program will appear online. This means that an EO account update could take between 30 to 60 days to be reflected on the online EO BMF and EO Select Check databases. TE/GE response to TAS research request (July 31, 2015). Thus, there is a disconnect between IRS internal database updating (approximately two weeks) and external (*i.e.*, online) database updating (30-60 days).

26 *See* IRM 25.7.5.1(1) (Jan. 1, 2015) (noting that the EO Standard Extract Program is a computer program that is run on a monthly basis (except for January) to allow for extraction of both entity and limited return information from EO accounts contained on the BMF).

FIGURE 1.21.1[27]



This potential month or two delay also impairs an EO's *right to quality service*, which includes taxpayers' right to receive prompt assistance in their dealings with the IRS.

The IRS's Suggestions for Those Impacted By the Updating Delay Miss the Mark

The IRS website notes that an automatically revoked organization that has had its exempt status reinstated will experience a delay from the time of reinstatement until EO Select Check and EO BMF are updated.[28] The IRS website explains the reason for this delay and advises the following to reinstated organizations who are not yet listed:

> Between updates to Select Check (Pub. 78 Data) and EO BMF, donors can rely on your organization's determination letter from the IRS as proof of your exempt status. Even if your organization remains on the list of automatically revoked organizations, donors can rely on an IRS determination letter dated on or after the effective revocation date. Donors also can confirm an organization's status by calling the IRS (toll-free) at 1-877-829-5500.[29]

However, the IRS's advice that donors can rely on an IRS determination letter or call the IRS for confirmation of an organization's status belies the IRS's own recognition that donors, particularly large donors and corporate or foundation grantors, often look *solely* to the IRS online databases to determine whether or not to make a donation or grant to an organization. A determination letter from the IRS (and, by extension, a phone call to the IRS) will in many cases 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 does appear on EO Select Check and EO BMF.

Further, the IRS's failure to timely update its online databases places the onus for proving exemption on the organization and causes a burden for potential grantors or donors to have to contact an organization and ask for a determination letter or contact the IRS and deal with lengthy telephone hold times, on a general TE/GE phone line that is not dedicated specifically to EO matters, to request confirmation

27 TE/GE response to TAS research request (July 31, 2015).

28 *See* IRS, *Exempt Organizations Select Check: Timing of Database Updates for Organizations Whose Exempt Status Is Reinstated*, *available at* http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check:-Timing-of-Database-Updates-for-Organizations-Whose-Exempt-Status-Is-Reinstated.

29 *Id*.

In fact, the IRS has stated that its future efficiency lies in providing taxpayers with "self-service" electronic options; thus, Tax Exempt and Government Entity's (TE/GE) strategy to drive grantors and donors to the phone for Exempt Organization (EO) verification is out of step with the IRS's own Concept of Operations.

of exempt status.[30] In FY 2015, callers to the TE/GE toll-free line waited an average of 23.4 minutes to speak to an IRS representative, an increase of almost five minutes from the 18.7 minute average hold time in FY 2014.[31] In addition, the number of IRS "courtesy disconnects" for the TE/GE phone line increased dramatically, from 4,380 in FY 2014 to 23,871 in FY 2015, a 445 percent jump.[32] Finally, the IRS customer service representative (CSR) level of service for this phone line dropped from 68 percent in FY 2014 to 60 percent in FY 2015.[33] As the IRS is expected to experience continued budget and hiring constraints, TE/GE telephone hold times and courtesy disconnects will likely continue to increase and the CSR level of service will likely continue to decrease. In fact, the IRS has stated that its future efficiency lies in providing taxpayers with "self-service" electronic options; thus, TE/GE's strategy to drive grantors and donors to the phone for EO verification is out of step with the IRS's own Concept of Operations.[34]

Finally, the IRS's delay in updating its online databases undermines the public's (*i.e.*, potential donors or grantors) *right to be informed*, which includes taxpayers' right to know what they need to do to comply with the tax laws. The IRS's delay prevents the public from finding out about certain organizations that are tax exempt and eligible to receive tax deductible contributions.

This problem is magnified for an organization that has had its exemption automatically revoked in error, as the organization should never have been removed from the IRS's online lists and now may face a significant delay getting back on them, thereby hampering its fundraising efforts.[35] In sum, the failure to

30 In addition, a reinstated automatically revoked organization may be reluctant to show its new determination letter to potential donors or grantors as it draws attention to the fact that the organization was automatically revoked.

31 IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015).

32 IRS, *Custom Joint Operations Center Report* (Oct. 30, 2015). The term "courtesy disconnect" is used when the IRS essentially hangs up on a taxpayer because its switchboard is overloaded and cannot handle additional calls.

33 *Id*. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015).

34 *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*, *supra*; 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*, *supra*. In describing the future vision of the IRS, IRS Commissioner John Koskinen stated, "Most things that taxpayers need to do to fulfill their obligations could be done virtually, and there would be much less need for in-person help, either by waiting in line at an IRS assistance center or calling the IRS." *Prepared Remarks of John A. Koskinen, Commissioner, Internal Revenue Service, Before the National Press Club* (Mar. 31, 2015), *available at* https://www.irs.gov/uac/Newsroom/Commissioner-Koskinen-Speech-before-the-National-Press-Club.

35 The IRS states that "erroneous revocations are identified through taxpayer correspondence and referrals from the call-site." TE/GE response to TAS research request (July 31, 2015). In other words, the onus is on the erroneously automatically revoked organization to contact the IRS to correct the issue. Once the IRS is contacted about an erroneous automatic revocation, the Employee Plans/Exempt Organizations (EP/EO) Determinations Processing Unit ("Correspondence") will conduct research to determine if the revocation was indeed erroneous. The Correspondence Unit will then send the organization a letter affirming that it was erroneously revoked or that the revocation was correct. If the organization was erroneously revoked, the Correspondence Unit places the name of the organization on a spreadsheet, which it sends weekly to Ogden to remove the organizations listed from the EO Select Check list of automatically revoked organizations. The IRS indicates that these correspondence inquiries are typically completed in 30-45 days. TE/GE response to TAS research request (July 31, 2015). Regarding the reinstatement process for organizations that were erroneously automatically revoked, the IRS states that it generally does not request manual updates to EO Select Check data unless it identifies an organization (for example, through an inquiry) that should be listed but for some reason is not picked up by the automated updating process. If the IRS does not do a manual update, then the organization must go through the normal monthly updating process for both EO Select Check and EO BMF after an internal record correction is made. TE/GE response to TAS research request (Dec. 1, 2015).

list a reinstated automatically revoked organization in its online databases in a timely manner can cause an organization to lose critical donations or grants, which may be an existential issue for some organizations.

The IRS also acknowledges these delays in its TE/GE IRM. For example, the IRS instructs its employees who are responding to a telephone call regarding an organization's omission from the EO BMF to "advise the customer that due to a systemic problem, the online 'lists' were not updated to reflect the exempt [sic] recognition."[36] The IRS also instructs its employees to advise organizations that it can take up to two months for a record of an organization's exempt status to be reflected on the online list and to offer to send an affirmation letter to the organization.[37] However, an affirmation letter is similar to a determination letter, and may not be sufficient to satisfy potential donors or grantors that rely solely on the IRS's online databases.

More Frequent Updates to EO Online Databases Are a Simple Solution

The IRS's delay in updating the online lists of Exempt Organizations (EOs) that are relied upon by both individuals and organizations harms reinstated organizations and misleads taxpayers, thereby abridging core taxpayer rights. This problem can be significantly mitigated if the IRS updates these lists more frequently.

The solution to this problem is simple — the IRS must update its online databases of EOs more frequently. The monthly updating (except for January) of EO Select Check is a great improvement over the quarterly updating of the old Publication 78 and the IRS is to be commended for this. However, more frequent updating of EO Select Check and EO BMF is now needed. The IRS updates other EO online lists more frequently than once a month (or once every two months). For example, the IRS updates its online list of Form 990-N (e-Postcard) filers weekly.[38] The IRS should similarly update EO Select Check and EO BMF, or provide an online addendum to these databases, on a weekly basis. The IRS should be able to change the programming of the databases from monthly to weekly, just as it made the change from quarterly to monthly updating.[39] However, until this change can be implemented, the IRS should manually update its online databases.

Currently, in between its regular online updating schedule, the IRS can manually update its EO Select Check listings of organizations eligible to receive tax deductible contributions and automatically revoked organizations by sending a request to the TE/GE Business Systems Planning Submission Processing Programs unit and this process can be as short as a day.[40] In fact, the National Taxpayer

36 IRM 21.3.8.3.8(1)(d) (Oct. 1, 2015).

37 IRM 21.3.8.3.8(1)(f) (Oct. 1, 2015); IRM 21.3.8.12.13(5) (Nov. 16, 2012). An affirmation letter, Letter 4168-C, *Letter Affirming 501(c) Exemption*, is a letter sent to organizations that call the IRS wishing to obtain written confirmation of their exemption.

38 *See* IRS, *Exempt Organizations Select Check: Frequently Asked Questions*, FAQ #5, *available at* http://www.irs.gov/pub/irs-tege/faqs_eo_selectcheck.pdf.

39 In a response to a TAS information request regarding whether the IRS can update EO BMF and EO Select Check more frequently than the current monthly (except for January) intervals, the IRS stated that the program used to run these two extracts only runs every four weeks, and "there is no way that the IT programmers can run the extracts more frequently." TE/GE response to TAS research request (Dec. 1, 2015).

40 TE/GE response to TAS research request (July 31, 2015). Organizations have come to TAS for assistance when they are at risk of losing grants because they are not listed in the IRS's online databases and TAS successfully advocates for a manual EO Select Check update.

Advocate has directed TAS employees to require the IRS to do these updates manually within 24 hours.[41] However, the IRS states that it cannot update the EO BMF manually.[42]

CONCLUSION

The IRS's delay in updating the online lists of EOs that are relied upon by both individuals and organizations harms reinstated organizations and misleads taxpayers, thereby abridging core taxpayer rights. This problem can be significantly mitigated if the IRS updates these lists more frequently.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Update EO BMF and Select Check on a weekly basis as is the case for Form 990-N updates.
2. Until appropriate programming changes can be made, update EO Select Check manually.
3. 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.

41 In a February 2015 message to TAS employees, the National Taxpayer Advocate directed her case advocates to request manual updates within 24 hours if the IRS agrees an organization should be listed on EO Select Check as eligible to receive tax deductible contributions and to request an organization's removal from the automatic revocation list if this revocation was erroneous. TAS Wednesday Weekly, *Updates to Exempt Organizations "Select Check"* (Feb. 4, 2015).

42 TE/GE response to TAS research request (July 31, 2015). When asked why it cannot update the EO BMF manually, the IRS stated that the EO BMF is prepared by its IT personnel during a timeframe available only once a month, "except in January IT is busy with other priorities and the EO BMF is not prepared." TE/GE response to TAS research request (Dec. 1, 2015).

INTRODUCTION: The IRS Can Do More to Improve Its Administration of the Earned Income Tax Credit and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights

The Earned Income Tax Credit (EITC), enacted as a work incentive in the Tax Reduction Act of 1975, has become one of the government's largest means-tested anti-poverty programs.[1] Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy "application" process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of case workers and local agencies. For instance, the EITC has less than one percent in administrative costs.[2] This is compared to administrative costs of 41.8 percent for the Women, Infants, and Children (WIC) program.[3]

To effectively administer the EITC, the IRS must understand the characteristics of EITC taxpayers. Generally speaking, low income taxpayers share a unique set of attributes compared to the average U.S. taxpayer. For instance, the low income taxpayer is more likely to be less educated. Of all able-bodied adults between the ages of 25 and 55 living in the bottom third of income distribution, 23 percent had less than a high school education, compared to five percent of the comparable group living in the top two-thirds of the income distribution.[4] Nearly two-thirds of working-age adults who experience consistent income poverty have one or more disabilities.[5] Low income families experience lower literacy rates.[6] Twenty-four percent of working-age adults with limited English proficiency live below the poverty line, whereas 13 percent of the comparable group of English speakers live below the poverty line.[7]

Low income households are more likely to be unbanked than middle to upper-income households. In fact, approximately 39 percent of households with income below $30,000 per year do not have a bank account.[8] Approximately 28 percent of households with an income below $15,000 do not have a bank account.[9] The absence of a bank account can impact a taxpayer's ability to substantiate their income and expenses for an EITC claim.

Lack of transportation and accessible child care services limit the ability of low income taxpayers to earn income.[10] Many low income taxpayers are often juggling competing obligations at one time, such

1 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975).

2 General Accounting Office (GAO), *Tax Administration Earned Income Noncompliance* 6 (May 8, 1997).

3 *WIC Program: Nutrition Service and Administrative Costs* (Mar. 6, 2015).

4 Isabel Sawhill and Quentin Karpilow, The Social Genome Project at Brookings, *Strategies for Assisting Low-Income Families* 4-5 (June 28, 2013).

5 Shawn Fremstad, Center for Economic and Policy Research, *Half in Ten: Why Taking Disability into Account Is Essential to Reducing Income Poverty and Expanding Economic Inclusion* 2 (Sept. 2009). Consistent income poverty is measured as more than 36 months of income poverty during a 48-month period. *Id*.

6 The Urban Child Institute, *Poverty Can Jeopardize the Development of Literacy and Early Reading Habits* (Aug. 30, 2012), *available at* http://www.urbanchildinstitute.org/articles/research-to-policy/policy/poverty-can-jeopardize-the-development-of-literacy-and-early.

7 Brookings Institute, *Investing in English Skills: The Limited English Proficient Workforce in U.S. Metropolitan Areas* (Sept. 24, 2014), *available at* http://www.brookings.edu/research/reports2/2014/09/english-skills#/M10580.

8 Federal Deposit Insurance Corporation (FDIC), *2013 FDIC National Survey of Unbanked and Underbanked Households* 17 (Oct. 2014). For the purposes of this survey, "unbanked" means that no one in the household had a savings or checking account. *Id*. at 4.

9 *Id*.

10 David K. Shipler, *The Working Poor, Invisible in America* 45, 52 (Alfred A. Knopf, 2004).

as multiple jobs, child care, health problems, and financial strains. These taxpayers may not be able to dedicate their time to an audit of their EITC claim even if they have a legitimate claim. In addition, low income taxpayers tend to be more transitory. Between 2012 and 2013, 20.5 percent of those below 100 percent poverty changed residences, while only 11.7 percent of the general population moved during the same time.[11] The transiency of this taxpayer population negatively affects their ability to respond to IRS correspondence in a timely manner. The "Characteristics of Taxpayers Claiming the Earned Income Tax Credit" infographic illustrates the general characteristics of taxpayers claiming the EITC.

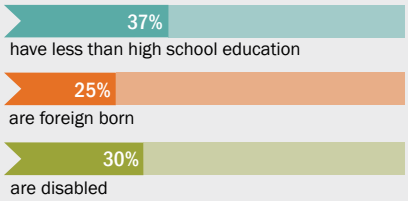
11 U.S. Census Bureau, *Current Population Survey, 2013 Annual Social and Economic Supplement* (Nov. 2013).

Characteristics of Taxpayers Claiming the
EARNED INCOME TAX CREDIT

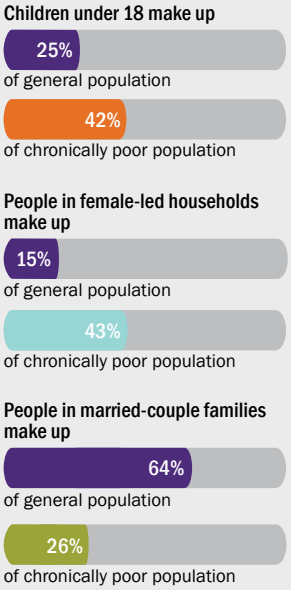
Low income taxpayers are more likely to have:

- Limited English proficiency
- Limited computer access
- Lower education levels
- Lower literacy rates
- Higher level of disabilities

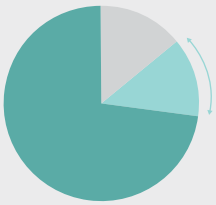
Low income taxpayers living under 125% of poverty levels



Comparison of the general and chronically poor populations



73-87% of qualifying children claimed for EITC are claimed correctly



Low income taxpayers are more likely to face specific limitations

Absence of a bank account hinders ability to verify income and expenses

About 39% of households with income below $30,000 per year do not have a bank account.

About 28% of households with income below $15,000 per year do not have a bank account.

Changing residences hinders ability to respond timely to IRS correspondence

From 2012 to 2013, over 20% of taxpayers below poverty level moved compared to less than 12% in the general population.

A 2004 TAS study found 43% of taxpayers had valid or partially valid EITC claims but couldn't successfully complete the correspondence exam process

The poor spend a higher percent of their income on transportation costs

Individuals below poverty spend over four times as much of their wage income on transportation as those who are above poverty level.

Low income families spend a considerably higher portion of their income on child care

On average, families with employed mothers spent about 7.2% of their income on child care; however, families with income less than $1,500 per month spent 39.6% of their family income on child care.

Limited English proficiency: www.brookings.edu/research/reports2/2014/09/english-skills#/M10580. Limited computer access: Forrester, North American Consumer Technographics Online Benchmark Survey (Part 2), 2014. Lower education levels: Isabel Sawhill and Quentin Karpilow, The Social Genome Project at Brookings, *Strategies for Assisting Low-Income Families* 4-5 (June 28, 2013). Lower literacy rates: www.urbanchildinstitute.org/articles/research-to-policy/policy/poverty-can-jeopardize-the-development-of-literacy-and-early. Higher levels of disability: http://talkpoverty.org/2014/09/19/disability-cause-consequence-poverty/. Comparisons of the general and chronically poor populations: Edwards, A. N. (Jan. 2014), *Dynamics of Economic Well-Being: Poverty 2009-2011*, United States Census Bureau. Children claimed for EITC: IRS, Research, Analysis and Statistics, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008* Returns 5 (Aug. 2014). Low income taxpayers living under 125% of poverty levels: (U.S. Census Bureau, 2015). Absence of a bank account: Federal Deposit Insurance Corporation (FDIC), 2013 FDIC National Survey of Unbanked and Underbanked Households 17 (Oct. 2014); Households moving: U.S. Census general mobility 2012-2013; At least partially valid EITC claims: National Taxpayer Advocate 2004 Annual Report to Congress vol. 2. Lack of transportation: www.urban.org/research/publication/impact-rising-gas-prices-below-poverty-commuters. Child care: www.pewresearch.org/fact-tank/2014/04/08/rising-cost-of-child-care-may-help-explain-increase-in-stay-at-home-moms/.

The EITC is a sizable credit, with approximately 26.7 million people receiving over $65 billion in EITC for tax year (TY) 2014.[12] Taxpayers use the credit to supplement their wages to pay for basic living expenses such as food, housing, and transportation costs. In 2013, the EITC lifted about 6.2 million people out of poverty.[13]

The EITC is associated with a high improper payment rate.[14] The IRS currently estimates that the EITC improper payment rate is 27 percent (which accounts for an estimated $17.7 billion in improper payments).[15] Despite much attention to this issue, the current improper payment rate has increased slightly from the improper rate measured in 2004, when it was 25 percent.[16] However, for context, EITC overclaims account for just seven percent of gross individual income tax noncompliance, while business income underreported by individuals accounts for 51.9 percent.[17] Improper EITC payments nonetheless continue to present a problem that cannot be ignored.

As Professor Leslie Book points out, EITC noncompliance is actually "a series of problems reflecting very different types and degrees of noncompliance."[18] As a result, proposals and programs to address EITC noncompliance must avoid a one-size-fits-all approach and instead "properly reflect the true dimensions of noncompliance within the EITC program, including ever-changing substantive rules, a fairly complex enforcement process, and the characteristics and circumstances of the appropriate taxpaying community."[19] Professor Book defines eight types of noncompliance, which he argues should serve as the basis for the IRS's action.[20]

Three types of noncompliance that are particularly pertinent to EITC compliance include: procedural noncompliance, unknowing noncompliance, and brokered noncompliance.[21] Procedural noncompliance occurs when the taxpayer cannot follow the EITC rules. In terms of an EITC claim, you may see procedural noncompliance when the IRS requests substantiating documentation from the taxpayer during an audit and the taxpayer responds with incorrect paperwork. Unknowing noncompliance occurs when an error is attributable to the complex and changing EITC rules. This error could occur when a taxpayer who was previously eligible for the EITC is no longer eligible because of a change in circumstances that he or she does not realize makes the taxpayer currently ineligible. Last, brokered noncompliance occurs

12 IRS, *About EITC*, *available at* https://www.eitc.irs.gov/EITC-Central/abouteitc (last visited Dec. 9, 2015).

13 Center on Budget Policy and Priorities, *New Research: EITC Boosts Employment; Lifts Many More Out of Poverty Than Previously Thought*, *available at* http://www.cbpp.org/blog/new-research-eitc-boosts-employment-lifts-many-more-out-of-poverty-than-previously-thought (last visited Sept. 23, 2015).

14 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." *Improper Payments Elimination And Recovery Act of 2010*, Pub. L. No. 111-204, § 2(f)(2) (2010).

15 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance with the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015).

16 *Id*. The lowest improper payment measurement since 2004 was 23 percent, which occurred in 2012. *Id*.

17 IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012). The IRS estimates $235 billion in individual income tax underreporting for tax year (TY) 2006 with $122 billion of this amount attributable to business income underreported by individuals as sole proprietors on Schedule C (Profit or Loss from Business) or as farmers on Schedule F (Profit or Loss from Farming). Department of the Treasury, *Fiscal Year 2014 Agency Financial Report* 197 (Nov. 17, 2014). The IRS provided a lower bound estimate of $16.2 billion in EITC overclaims for TY 2014 ($16.2 billion / $235 billion is about seven percent).

18 Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 Kan. L. Rev. 1145, 1147 (2003).

19 *Id*. at 1147-48.

20 *Id*. at 1166. Mr. Book relies on the work of sociologists Robert Kidder and Craig McEwen in this analysis.

21 *Id*. at 1167-73.

when the taxpayer receives inaccurate advice or assistance from a tax professional. In our Most Serious Problems below, we discuss each of these types of noncompliance.

The Office of Management and Budget (OMB) recently requested that the Department of Treasury (Treasury) analyze the problem of EITC improper payments. The OMB encouraged Treasury to "continue to explore new and innovative ways to address the problem and to continue to attack this challenge with every tool at our disposal."[22] OMB requested an action plan from Treasury to meet improper payment reduction targets. One pertinent issue OMB wanted addressed included the question: What are the one or two actions you are not already engaged in (but could realistically engage in) that would lead to a significant decrease in improper payments in the EITC program?[23] In the material below, the National Taxpayer Advocate will recommend several actions that can be realistically adopted to improve EITC compliance and reduce improper payments.

Improvement to the EITC audit program is also an important step to meeting Congress's expectations to "engage in the first top to bottom review since 1996 of how federal policies can better support work, strengthen families, and move America forward."[24] Based on this expectation, the National Taxpayer Advocate provides her concerns and recommendations for improving EITC compliance in the Most Serious Problems described below:

- *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;*
- *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;* and
- *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*

We believe that if the IRS and Congress adopt the recommendations set forth in these discusisons, we will achieve improved EITC voluntary compliance. Some of our proposals call for innovation, improved training, person-to-person contact, and staffing the program with employees that have a different set of skills. In order to improve the future compliance and protect the taxpayer rights of low income individuals, these resources are a necessary investment.

22 Shaun Donovan, Director, OMB, *Letter to Honorable Jacob J. Lew, Secretary of the Treasury* (Feb. 26, 2015).

23 *Id*.

24 *Challenges Facing Low-Income Individuals and Families in Today's Economy: Hearing Before the Subcomm. on Human Resources of the H. Comm. on Ways and Means*, 114th Cong. (2015) (statement of Subcommittee Chairman Charles Boustany).

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

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) is a complicated tax law that depends on many factors, including a taxpayer's income, marital status, and relationship to children claimed. As discussed in the introduction to this section, the target population for the EITC shares a unique set of attributes that create inherent challenges for EITC compliance.[2] Additionally, the population claiming the EITC is constantly changing, with approximately one-third of the eligible population changing every year.[3]

The churning of the eligible population occurs because EITC eligibility requirements include the type of issues that change frequently, such as living and parenting arrangements and the gain or loss of a job. However, when one-third of the EITC population cycles in and out each year, it is very difficult for taxpayers to understand what the rules are and how the rules apply to the taxpayer's particular circumstances.

The IRS does not accommodate low income taxpayers' communication behaviors and largely ignores what channels these taxpayers need or prefer to use. As a consequence, taxpayers make avoidable errors and inaccurate EITC claims, driving up the improper payment rate.[4]

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 *See* Introduction: *The IRS Can Do More To Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

3 IRS, *EITC Fast Facts*, *available at* http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff (last visited Sept. 16, 2015). For more information on the changing population of taxpayers eligible for EITC, see National Taxpayer Advocate 2013 Annual Report to Congress 109-10.

4 For a more detailed discussion of the EITC improper payment rate, see Introduction: *The IRS Can Do More To Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

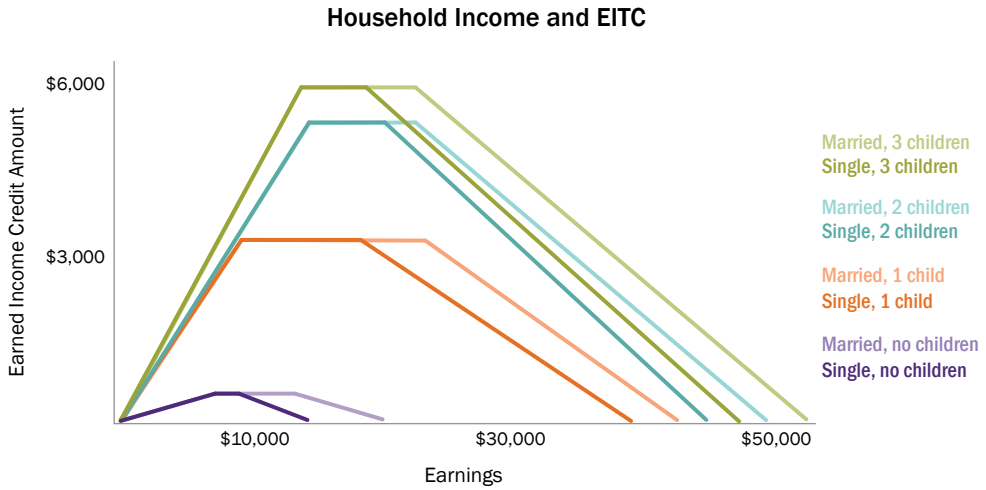
ANALYSIS OF THE PROBLEM

Background

Generally, the amount of the EITC increases with earned income, creating an incentive to work.[5] The credit has a phase-in range (increasing the credit as the taxpayer's wages go up), a plateau range, and a phase-out range (decreasing the credit as the taxpayer's wages continue to increase, eventually making the taxpayer ineligible). The EITC amount also increases if a worker has one, two, or three qualifying children, but is disallowed if the worker has more than $3,350 of investment income.[6] For tax year (TY) 2014, the EITC phases out at an income ceiling of $52,427 (for a married couple filing jointly with three or more qualifying children), and this number changes annually.[7]

Figure 1.22.1 demonstrates the plateau effect of the EITC based on income, filing status, and number of children.

FIGURE 1.22.1, Amount of EITC Based on Earnings



The information listed above only covers income eligibility. The requirements when claiming a child are even more detailed. To have a qualifying child for EITC purposes, the child must meet three tests: age, relationship, and residence.

- Under the *age* requirement, the child being claimed must be younger than the taxpayer and must be under the age of 19 at the end of the calendar year. The child can be under the age of 24 if he or she is a full-time student, and if the child is permanently and totally disabled, then he or she can be any age.[8]

5 See Stacy Dickert, Scott Houser & John Karl Scholz, *The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation*, 9 Tax Policy and the Economy (James M. Porterba ed., 1995); Janet Holtzblatt, *Trade-offs Between Targeting and Simplicity: Lessons from the U.S. and British Experiences with Refundable Tax Credits* 13 (2004) (citing Dickert, Houser & Scholz among academic economists who "estimated that expansions of the EITC between 1993 and 1996 would induce more than half a million families to move from welfare to work").

6 *See generally* IRC § 32(i); Instructions for Form 1040, *U.S. Individual Tax Return* 53 (Jan. 26, 2015).

7 Internal Revenue Code (IRC) § 32(b); IRS, *Publication 596, Earned Income Credit (EIC)* 4 (Dec. 18, 2014).

8 IRC § 152(c)(3).

- Under the *relationship* requirement, the taxpayer generally may claim the EITC for a child who is his or her son or daughter, stepchild, foster or adopted child, or a descendant of any of them (*e.g.*, a grandchild), or a child who is a sibling, stepsibling, or half-sibling of the taxpayer, or a descendant of any of them (*e.g.*, a nephew or grandnephew).[9]
- Under the *residence* requirement, a taxpayer generally may claim the credit only with respect to a child who lives with the taxpayer for more than half the calendar year.[10]

Taxpayers without children have separate requirements. First, they must live in the United States for more than half of the year.[11] The taxpayer (or his or her spouse if filing jointly) must be at least 25 years old but below 65 years old.[12] Last, the taxpayer cannot be claimed by someone else as a dependent.[13]

The struggle that low income taxpayers face in trying to navigate the complex EITC rules is not just a theoretical problem. The recent case of *Cowan v. Commissioner* demonstrates the severity of the situation.[14] In this case, the state of Ohio appointed Ms. Cowan to be the guardian of a child, Marquis, from 1991 until 2004. Under state law, the guardianship automatically terminated when Marquis turned 18, which occurred in 2004. However, Ms. Cowan continued to provide Marquis a home after he turned 18, and they continued to regard themselves as a family unit. Ms. Cowan never adopted Marquis, the legal significance of which she did not understand. She stipulated for trial that had she known of the importance of adoption, she would have adopted Marquis.

Later, Marquis had a daughter, and they both lived with Ms. Cowan. In 2011, Ms. Cowan claimed Marquis's daughter as her granddaughter for the EITC. The court disallowed this claim since she and Marquis legally are not related. However, Ms. Cowan and Marquis *believe* and *act* as if they are family. And it was based on that belief that Ms. Cowan filed her 2011 tax return. Had Ms. Cowan understood the legal significance of the terminated guardianship and of adopting Marquis, she could have taken steps to ensure the outcome was in her favor.

In situations where taxpayers are operating under a complex system of rules without the necessary tools, the concept of procedural justice is impacted. "Procedural justice" (or fairness) is a concept that considers how a taxpayer is treated by the IRS. It looks to more than just the outcome of the interaction; it also considers if the interaction was "nonjudgmental, polite, and respectful of the individual's rights."[15] Procedural justice is an important concept to consider when discussing EITC cases because a taxpayer's perception of procedural fairness will affect his or her perception of the agency's fairness and legitimacy, as well as his or her willingness to comply with the tax laws.[16] The process of establishing EITC compliance can seem unjust if it is designed in a way that all but ignores the needs and limitations of the population being served.[17]

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9 IRC § 152(c)(2).

10 IRC § 152(c)(1)(B).

11 IRC § 32(c)(1)(A)(ii)(I).

12 IRC § 32(c)(1)(A)(ii)(II).

13 IRC § 32(c)(1)(A)(ii)(III).

14 T.C. Memo. 2015-85.

15 Nina E. Olson, *Procedural Justice for All: A Taxpayer Rights Analysis of IRS Earned Income Credit Compliance Strategy*, 22 Advances in Taxation 3 (John Hasseldine ed., 2015).

16 *Id*. at 3-4.

17 For information on how the EITC audit process in particular can be improved, see Most Serious Problem: *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.*

In the current customer service environment, procedural justice is undermined by the IRS's failure to provide tailored education and assistance to low income taxpayers, coupled with an examination strategy that creates significant burdens for EITC taxpayers trying to prove their eligibility.[18] As a consequence, EITC noncompliance continues at a high level, resistant to the IRS's present actions.

The IRS Needs to Establish a Dedicated Helpline for EITC Taxpayers During the Filing Season to Improve Filing Compliance and the Improper Payment Rate

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. The IRS also uses an outreach and education strategy directed toward both preparers and taxpayers. For instance, on the IRS website, taxpayers are able to use a tool to see if they qualify for the EITC.[19] The website also offers links that contain a wealth of information according to topic. For instance, the taxpayer can find information pertaining to the income limits, credit amounts, and special rules.[20]

> … TAS research… has shown that taxpayers claiming the Earned Income Tax Credit (EITC) need additional assistance to understand EITC eligibility and avoid noncompliance. Accordingly, the National Taxpayer Advocate recommends the IRS establish a dedicated helpline for EITC questions during the filing season to meet that need.

The IRS also makes available bilingual pamphlets and publications. Publication 962, *Earned Income Tax Credit*, is a pamphlet that addresses the main requirements for EITC and provides the taxpayers with additional resources if they have questions. These publications are often disseminated throughout the community at government offices and nonprofit agencies. The IRS takes advantage of TV, radio, and social media to present public service announcements. The best example of this outreach is EITC Awareness Day, which is a "one-day blitz in mainstream and social media to reach the broadest possible range of potentially eligible taxpayers."[21]

Despite all this important high-level outreach activity, TAS research, discussed below, has shown that taxpayers claiming the EITC need additional assistance to understand EITC eligibility and avoid noncompliance.[22] Accordingly, the National Taxpayer Advocate recommends the IRS establish a dedicated helpline for EITC questions during the filing season to meet that need. Assistors servicing the helpline should receive training to improve interviewing and listening skills similar to those used by social workers administering a social benefit program.[23] Taxpayers could explain their circumstances and receive specific guidance on how the law applies to those circumstances. While these answers would be nonbinding on the IRS, the assistors on the helpline would focus on getting taxpayers to the right answer. The helpline would help taxpayers check the accuracy of advice

18 *See* Most Serious Problem: *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*.

19 IRS, Use the EITC Assistant, *available at* http://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit/Use-the-EITC-Assistant (last visited Sept. 18, 2015).

20 IRS, *Earned Income Tax Credit (EITC)*, *available at* http://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit (last visited Sept. 18, 2015).

21 IRS, *EITC Awareness Day*, *available at* http://www.eitc.irs.gov/Partner-Toolkit/awarenessday (last visited Sept. 18, 2015).

22 *See* National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-82 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94-117 (*IRS Earned Income Credit Audits – A Challenge to Taxpayers*).

23 *See* National Taxpayer Advocate 2009 Annual Report to Congress 119-20; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 86-7.

provided them by untrained or unscrupulous return preparers.[24] Not only would individual taxpayers benefit from this helpline, but the IRS would learn from the taxpayers themselves what the sources of confusion are with respect to the EITC. In this way, through a dialogue with taxpayers, the IRS can update and refine its general information for *all* EITC taxpayers.[25]

TAS Research Studies Show that Low Income Taxpayers Need Person-to-Person Contacts In Order to Understand Their Tax Obligations

The first TAS study to support this recommendation occurred in 2004, when TAS explored the effectiveness of EITC audits.[26] In the 2004 study, TAS looked at a representative sample of taxpayers whose EITC was disallowed, in whole or part, in IRS audits and who later requested an audit reconsideration of that disallowance. The results showed that 45 percent of the taxpayers who went to TAS for assistance received additional EITC as a result of the audit reconsideration, as compared to 40 percent who asked Examination for reconsideration. Forty-two percent of the sample responded late or not at all to the original audit inquiry. However, about 43 percent of this group had favorable outcomes from the audit reconsideration process, retaining about 96 percent of the total amount of EITC originally claimed on their returns.

The percentage of taxpayers who received EITC in the audit reconsideration increased in direct proportion to the number of telephone contacts TAS initiated. Overall, only 38 percent of taxpayers who went through the audit reconsideration process but received no phone calls were awarded EITC. This percentage increased to 67 percent for taxpayers who received three or more calls. The 2004 study demonstrated the importance of making personal contact with low income taxpayers under audit. If personal contact could be available earlier in the process, significant noncompliance and future audits potentially could be avoided.

In a 2007 study, TAS identified the types of barriers taxpayers face in the EITC audit process as well as the effect of representation in EITC audits. This study discovered that on a very basic level, 26.5 percent of the surveyed taxpayers did not know from reading the EITC audit letter that they were being audited.[27] Nearly 40 percent did not understand what the IRS was questioning in the audit.[28] Nearly 70 percent of the taxpayers preferred to communicate with the IRS directly instead of the correspondence audit process, 46 percent preferred to communicate by telephone, and 23 percent preferred to communicate in-person.[29] This shows that IRS written communication (both in style and format) does not line up with what low income taxpayers need to be able to engage effectively with the IRS and learn.

The IRS has studied discrete components of low income taxpayers' lives. For instance, as part of the Qualifying Child Residency Certification Study in 2005, the IRS looked to the importance of mobility

24 For an analysis of the role of return preparers in EITC noncompliance and the IRS efforts to address this issue, 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*.

25 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*, *supra*, for a discussion of the importance of a "positive feedback loop" between IRS and taxpayers.

26 See National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-82 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

27 See National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 104. EITC returns are selected for audit differently now than returns were selected for audit in 2007. We do not know if this study would create the same results today.

28 *Id*.

29 *Id.* at 106-7.

of low income taxpayers and taxpayers' opinions of the EITC certification process.[30] The IRS learned that between six and 11 percent of the letters sent by the IRS as part of the study were undeliverable, and almost one-half of the taxpayers selected for a follow-up telephone survey could not be reached by mail or phone in TY 2003.[31]

A dedicated helpline would address low income taxpayers' needs by accommodating their mobility (taxpayers could call it regardless of mobility) *before* filing their tax returns. The helpline would help avoid future noncompliance and instill a sense of procedural justice for all taxpayers — that is, the IRS listened to their concerns and explained what taxpayers needed to do to be compliant.

The IRS Can Learn From the United Kingdom's Approach to Providing Assistance to Taxpayers Claiming Family- and Income-Based Credits

The National Taxpayer Advocate has consistently argued that low income taxpayers need customer service approaches fine-tuned for their specific needs and preferences.[32] In the United Kingdom, Her Majesty's Revenue and Customs (HMRC) has gradually shifted its focus from that of a compliance-driven agency to one that views taxpayers as customers. HMRC is committed to improving the "customer experience" for taxpayers claiming family and other tax credits and as a result it strives to "understand both customers' current communication behaviors, as well as how they would prefer to communicate with HMRC in the future."[33] For instance, HMRC has determined that taxpayers claiming tax credits largely prefer contacting the agency by telephone.[34] HMRC also studied when taxpayers are most likely to need assistance during the process of claiming a tax credit.[35] Last, HMRC studies taxpayers' experiences, perceptions, and attitudes.[36] This approach instills a sense of procedural justice into the process.[37]

Unlike the United States, 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

30 IRS, *IRS Earned Income Tax Credit (EITC) Initiative, Final Report to Congress* 23, 43 (Oct. 2005).

31 IRS, *IRS Earned Income Tax Credit (EITC) Initiatives, Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests* 19 (2008). One-third of the taxpayers selected for a follow-up telephone survey could not be reached by mail or phone in TY 2004. *Id*.

32 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 103-15; National Taxpayer Advocate 2011 Annual Report to Congress 296-312 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*); National Taxpayer Advocate 2008 Annual Report to Congress 227-42 (Most Serious Problem: *Suitability of the Examination Process*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 8-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

33 Her Majesty's Revenue and Customs, *Channels of Communication: Usage and Preferences Among Tax Credits Customers* 1 (Aug. 2013). *See also* Colin Payne, Julia Griggs, Mari Toomse-Smith and Hannah Silvester, NatCen Social Research, *Panel Study of Tax Credits Customers: Telephone Survey 2012: Reducing Error and Fraud, and the Transition to Universal Credit* (May 2013).

34 Her Majesty's Revenue and Customs, *Channels of Communication: Usage and Preferences Among Tax Credits Customers* 11 (Aug. 2013).

35 *Id*. at 12.

36 *See, e.g.*, Malen Davies, Rowan Foster, Pippa Lane and Lauren Small, Centre for Economic and Social Inclusion, *High Risk Renewals: Tax Credits Customers' Experiences of and Responses to the High Risk Renewals Intervention* (2013). The High Risk Renewal (HRR) intervention is used by HMRC "to target those tax credits customers identified as having a risk of error or fraud in their claim." *Id*. at 1. The interventions consist of an HRR letter in addition to a "tax credits renewal pack." *Id*. at 2. *See also* Chris Lord, Matt Barnes and Mari Toomse, NatCen Social Research, *Exploring the Dynamics of Tax Credits Renewal Behavior: Longitudinal Analysis of the Panel Survey of Tax Credits and Child Benefit Customers* (July 2012).

37 *Supra* note 15.

The law related to Earned Income Tax Credit (EITC) eligibility is complex. At the same time, the EITC is directed toward a population of taxpayers who are least able to navigate its complexity. Additionally, the population of eligible taxpayers is in constant flux because of changing personal circumstances. With these three elements in mind, education targeted toward taxpayers claiming the EITC is an important component for improving EITC compliance.

venue for taxpayers to make complaints.[38] A majority of taxpayers in the United Kingdom preferred using this dedicated helpline for their source of information over all other services provided by HMRC and the customer satisfaction was reported as highest with the helpline.[39] While 56 percent of the taxpayers used the helpline, the next largest group relied on the HRMC website (19 percent).[40] Some other options included local tax offices (two percent), professional advisors (one percent), and community-based volunteer organizations such as the Citizens Advice Bureau (two percent).[41]

Taking a similar approach could help the IRS pinpoint where mistakes and inadvertent errors are likely to occur in EITC claims, increase efficient use of resources, and encourage taxpayers' participation in EITC compliance. It will enable the IRS to tailor its outreach and education better, based on issues and confusion identified on the helpline. It will also allow taxpayers to check whether the information they receive from their tax return preparers about their eligibility is correct. We know in the United States, low income taxpayers are more likely to use an IRS walk-in office compared to taxpayers with higher incomes.[42] In a 2014 study, TAS 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.[43] This means that the current processes for low income taxpayers should be based on something other than correspondence.

A helpline would be less expensive than face-to-face assistance but still meet the needs of the low income population. By studying the best way to communicate with low income taxpayers, the IRS could determine why low income taxpayers prefer face-to-face assistance over telephone contact. If we can isolate the particular aspects of face-to-face assistance that taxpayers find helpful, it may very well be that the enhanced EITC helpline would also meet those aspects

38 Her Majesty's Revenue and Customs, *Tax Credits: General Enquiries*, *available at* https://www.gov.uk/government/organisations/hm-revenue-customs/contact/tax-credits-enquiries (last visited May 21, 2015).

39 Her Majesty's Revenue and Customs, *Channels of Communication: Usage and Preferences Among Tax Credits Customers* 25 (Aug. 2013).

40 *Id*. at 14.

41 *Id*. The Citizens Advice Bureau described its work as offering "information and advice through face-to-face, phone and email services, and online via Adviceguide.org.uk." Citizens Advice Bureau, *Introduction to the Citizens Advice service*, *available at* https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/who-we-are-and-what-we-do/introduction-to-the-citizens-advice-service/ (last accessed Oct. 9, 2015).

42 Eighty-two percent of low income taxpayers (with incomes under $15,000) reported being "very or somewhat likely" to use an IRS walk-in office compared to 63 percent of taxpayers with income of $75,000 or more. IRS Oversight Board, 2014 *Taxpayer Attitude Survey* 13 (Dec. 2014). The margin of error for the Oversight Board survey is 4 percent at the 95 percent confidence level.

43 National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 9. This study entailed a telephone survey of taxpayers eligible to use a Low Income Taxpayer Clinic for help with a federal tax problem. Participants had to be the person in the household responsible for handling federal income tax matters, they must have filed a federal tax return in the last three years, and their total annual household income could not exceed 250 percent of the federal poverty level. Respondents could check all applicable responses so results total more than 100 percent.

(one-on-one communication, no talk time limits, personal interaction).[44] Based on that assessment, the IRS should reevaluate how it currently serves low income taxpayers and build a system that meets the needs of taxpayers.

CONCLUSION

The law related to EITC eligibility is complex. At the same time, the EITC is directed toward a population of taxpayers who are least able to navigate its complexity. Additionally, the population of eligible taxpayers is in constant flux because of changing personal circumstances. With these three elements in mind, education targeted toward taxpayers claiming the EITC is an important component for improving EITC compliance. In particular, if taxpayers had access to a dedicated helpline, they would be able to confirm their understanding before filing a tax return or receive help if they have a question after entering into the audit process. This could reduce the number of mistakes and inadvertent errors.

The IRS should reevaluate how it serves the particular needs of low income taxpayers. There is a lot of research to indicate that low income taxpayers would benefit from service methods other than correspondence examinations. And yet, most work done with low income taxpayers is through the mail. The IRS should take this opportunity to study how low income taxpayers prefer to work with the IRS. Based on the results of that study, the current procedures should be revamped to optimize taxpayer participation. In doing this, the IRS will promote a sense of procedural justice in tax administration for low income taxpayers and positively impact EITC compliance. Doing this will also undermine unscrupulous and predatory preparers, which will further improve the improper payment rate.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct a study along the lines of the UK experiment to determine how best to serve low income taxpayers. This study should include interviews with taxpayers, nonprofit organizations, and IRS employees, to learn about taxpayer needs and communication preferences.
2. Based on the findings from the proposed study above, create a helpline dedicated to taxpayers who claim the EITC where taxpayers can call in and ask questions about their particular area of concern. This phone line should be staffed by employees with excellent listening and communication skills who have completed training in social work and who can answer specific questions related to EITC eligibility. The IRS should provide, in conjunction with TAS, special training on listening and communication.

44 The Senate Committee on Appropriations recently directed the IRS to conduct an analysis of the specific characteristics of the population of taxpayers that use the walk-in Taxpayer Assistance Centers. In particular, the committee directed the IRS to conduct this analysis along the same lines as an analysis conducted by HMRC. Financial Services and General Government Appropriations Bill of 2016, S.R. 000, 114th Cong. 30-31 (2015).

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

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) is a refundable credit, enacted as a work incentive in the Tax Reduction Act of 1975.[2] It has become one of the primary forms of public assistance for low income working taxpayers. Taxpayers eligible for the EITC often rely on the credit in order to make basic ends meet, such as to cover housing and transportation costs. The EITC is also associated with a high improper payment rate.[3] The IRS currently estimates that the EITC improper payment rate is 27 percent (which accounts for an estimated $17.7 billion in improper payments).[4] Despite much attention to this issue, the current improper payment rate has increased slightly from 2004, when it was 25 percent.[5] Thus, the IRS must balance the obligation of making sure every taxpayer eligible for the EITC receives it, with the obligation to minimize mistakes and fraud.[6]

The EITC is a complex law that involves eligibility rules based on a taxpayer's income, marital status, and parental arrangements, which can often change on a year-to-year basis. The population claiming the

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975). For a detailed history of the EITC, see Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit, 1969-99*, 53 Nat'l. Tax J. 983-1026 (Dec. 2000).

3 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, § 2(f)(2) (2010).

4 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015).

5 *Id*. The lowest improper payment measurement since 2004 was 25 percent, which occurred in 2012. *Id*.

6 For information on how the IRS is addressing the role that tax return preparers play in EITC noncompliance, 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*.

EITC is constantly in flux, with approximately one-third of the eligible population changing every year.[7] At the same time, the population of taxpayers who rely on the EITC share a common set of characteristics, such as low education and high transiency, which create challenges for taxpayer compliance.[8]

Notwithstanding these challenges the IRS persists in using traditional audits as its primary compliance tool. In fact, EITC audits make up 35 percent of all IRS audits despite the fact that EITC returns account for only 19 percent of all returns filed.[9] Because audits are resource-intensive, the IRS should focus its limited resources on audit methods proven to have the greatest direct and indirect effects on compliance in order to have the biggest impact on potentially erroneous EITC claims. The IRS primarily relies on the automated correspondence examination process to work EITC audits. TAS's review of this approach reveals the following concerns:

- The correspondence audit process creates barriers for low income taxpayers due to their unique attributes;
- 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;[10] and
- The IRS may not be auditing the group of EITC returns that have the most noncompliance, thereby diminishing the effectiveness of IRS efforts to improve future compliance and creating a burden for taxpayers.

Improving the EITC audit program is an important step to improving the improper payment rate, reducing taxpayer burden, and meeting Congress's expectations that the IRS "engage in the first top to bottom review since 1996 of how federal policies can better support work, strengthen families, and move America forward."[11] An improved audit process will also ensure procedural justice for low income taxpayers.[12]

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7 IRS, *EITC Fast Facts*, http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff (last visited Sept. 16, 2015). For more information on the changing population of taxpayers eligible for EITC, see National Taxpayer Advocate 2013 Annual Report to Congress 109-10.

8 See Introduction: *The IRS Can Do More to Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

9 IRS, *2014 Data Book*, table 9a, comparing the number of EITC returns filed and the number of EITC audits in footnote 5 of the same table.

10 For FY 2014, the exact no response rate is 45.6 percent. This calculation includes 255,286 default assessments minus 99,067 default assessments that involved some taxpayer contact, bringing the total of default assessments with no taxpayer contact to 156,219. In addition, 42,490 cases involving undeliverable mail were then added, for a total of 198,709 cases with either a default assessment and no contact or undeliverable notices. That number divided by the total of 435,639 equals 45.6 percent and represents the portion of taxpayers who did not respond to the EITC audit. Audit Information Management System Closed Case Database. *See Internal Revenue Service Oversight, Hearing Before the H. Subcomm. on Fin. Serv. and Gen. Gov't Comm. on Appropriations*, 113th Cong. 34 (2014) (statement of Nina E. Olson, National Taxpayer Advocate), *available at* http://www.finance.senate.gov/imo/media/doc/Olson%20-Testimony1.pdf.

11 *Challenges Facing Low-Income Individuals and Families in Today's Economy: Hearing Before the Subcomm. on Human Res. of the H. Comm. on Ways and Means*, 114th Cong. (2015) (statement of Subcommittee Chairman Charles Boustany). Additionally, the President's FY 2016 budget includes "strategic reinvestments in the IRS," which among other things, are intended to "help increase audit and collection coverage." *Examining Federal Improper Payments and Errors in the Death Master File, Hearing before the S. Comm. on Homeland Security and Governmental Affairs*, 114th Cong. (Mar. 16, 2015) (statement of David Mader, United States Controller, Office of Management and Budget). If the IRS does receive additional funding, now is a good opportunity to evaluate its EITC audit effectiveness.

12 "Procedural justice" (or fairness) is a concept that considers how a taxpayer is treated by the IRS. It looks to more than just the outcome of the interaction, it also considers if the interaction was "nonjudgmental, polite, and respectful of the individual's rights." It is an important concept to consider when discussing EITC audits because a taxpayer's perception of procedural fairness will affect his or her perception of the agency's fairness. Nina E. Olson, *Procedural Justice for All: A Taxpayer Rights Analysis of IRS Earned Income Credit Compliance Strategy*, *in* 22 Advances in Taxation 1, 3-4 (John Hasseldine ed., 2015).

ANALYSIS OF THE PROBLEM

The Correspondence Audit Process Creates Barriers for Low Income Taxpayers Due to Their Unique Attributes

As noted in the Introduction, EITC taxpayers face significant challenges in interacting with the IRS, including language, financial and computer literacy, transiency, and the other characteristics of low income and poverty populations.[13] Taxpayers claiming the EITC need to have a tailored examination process for a number of reasons, including language barriers, the inability to communicate clearly in writing, complexity of the tax law, and the volume of records required for verification.[14] The National Taxpayer Advocate has consistently argued that low income taxpayers need approaches fine-tuned for their specific needs and preferences.[15] The Treasury Inspector General for Tax Administration (TIGTA) also recently observed that "[IRS] compliance resources are limited, and additional alternatives to traditional compliance methods have not been developed. Consequently, the IRS does not address the majority of potentially erroneous EITC claims."[16] The Government Accountability Office (GAO) reported that effectiveness of audits may be limited partly because of regular backlogs in the audits, which result in delays in responding to taxpayer responses and inquiries.[17] Moreover, practitioners have expressed concern about the suitability of the correspondence examination for taxpayers claiming the EITC:

> The system itself of requiring the least sophisticated users to endure the most impersonal process creates many of the problems for low income taxpayers. In both the examination and collection phases of their case, low income taxpayers go from start straight through to levy without a person assigned individually to their case.[18]

An EITC Denial May Not Effectively Reflect a Taxpayer's Eligibility for the Credit

When the audit process does not meet taxpayer needs, any EITC denied to the taxpayer may reflect the taxpayer's inability to navigate the audit process rather than an improper payment.[19] When taxpayers

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13 See Introduction: *The IRS Can Do More To Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

14 National Taxpayer Advocate 2008 Annual Report to Congress 233. When it comes to complying with document requests, migratory living patterns, lack of education, lack of time (*e.g.*, holding multiple jobs), lack of transportation, and limited access to technology (internet, faxes, etc.) add to the difficulty of finding and submitting documents. National Taxpayer Advocate 2011 Annual Report to Congress 304.

15 For example, see National Taxpayer Advocate 2013 Annual Report to Congress 103-15 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*); National Taxpayer Advocate 2011 Annual Report to Congress 296-312 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*); National Taxpayer Advocate 2008 Annual Report to Congress 227-42 (Most Serious Problem: *Suitability of the Examination Process*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 8-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

16 TIGTA, Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015). Recently, a new law was enacted which will require the IRS to modify the timeframe for people claiming the EITC to receive their refunds. The new timeframe would mean that taxpayers claiming the EITC could not receive their refunds before February 15, with the intention of reducing fraud and improper payments. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 § 201 (2015).

17 GAO, *Fiscal Outlook: Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position* 15 (Oct. 1, 2015). The GAO concludes that legislative action and "significant changes" in the IRS compliance processes would be necessary to reduce EITC improper payments. *Id*.

18 *Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform, Hearing Before the S. Comm. on Fin.*, 114th Cong. (Mar. 10, 2015) (statement of Keith Fogg, Professor of Law and Director of Low Income Taxpayer Clinic (LITC) Villanova Law School).

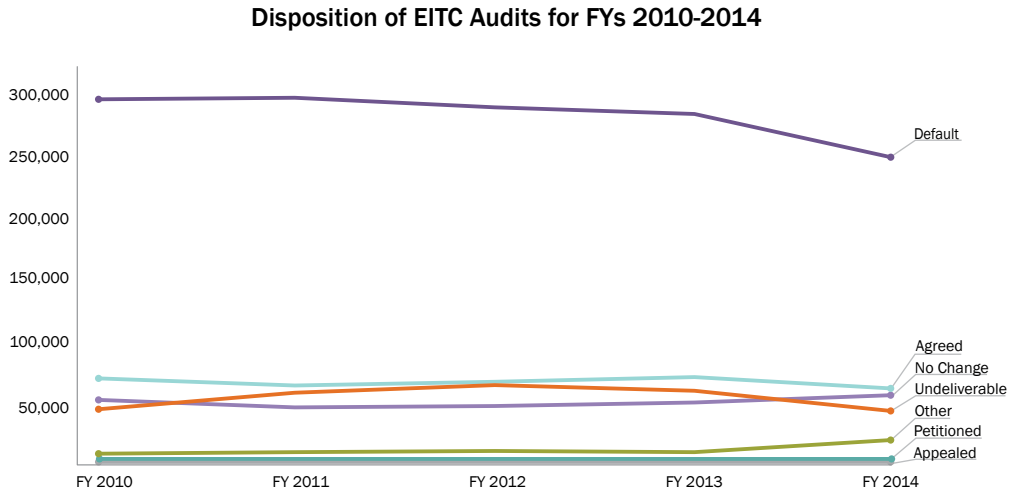
19 National Taxpayer Advocate 2011 Annual Report to Congress 301.

cannot obtain the information they need to substantiate a claim during an audit, they may not pursue the case and may not receive a benefit to which they are entitled. Even if the taxpayer is not eligible for the EITC in the year of audit, if they do not learn why they are ineligible through the audit process, they may just learn that they should not claim the EITC at all, despite being eligible in later years. Or the taxpayer may repeat the mistake in the following year, triggering the two-year ban under Internal Revenue Code (IRC) § 32(k).[20] Such a system does not promote future compliance.

Some taxpayers will appeal their EITC claim denials to the U.S. Tax Court. This increases systemic costs. The taxpayer may retain a *pro bono* attorney through his or her local Low Income Taxpayer Clinic.[21] Litigation will mean increased costs for the IRS in expanding the time of IRS attorneys and Appeals staff, in addition to the court's expenses. Litigation also creates a delay for the taxpayer to receive his or her refund. A TAS review conducted in 2012 examined a random sample of cases in which the taxpayer petitioned the Tax Court for review of IRS disallowance of the EITC and the IRS conceded the EITC issue in full without trial. On average, the taxpayers had to wait 513 days for their refund.[22] Furthermore, the IRS paid $17,400 in interest on delayed refunds in 90 cases.[23]

Figure 1.23.1 shows the disposition of each EITC audit between fiscal years (FY) 2010 and 2014. The overall trends have stayed relatively consistent over the five years.

FIGURE 1.23.1[24]



20 A law has been recently enacted which will allow the IRS to use math error authority in situations where the taxpayer has claimed the EITC during a time that he or she is barred from doing so under IRC § 32(k). Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 § 208 (2015).

21 LITCs represent low income individuals in disputes with the IRS, including audits, appeals, collection matters, and federal tax litigation. *See* IRS Publication 4134, *Low Income Taxpayer Clinic List* (Jan. 2015).

22 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 86.

23 *Id*.

24 IRS Compliance Data Warehouse (CDW), Audit Information Management System through July 2015. This data represents information provided by the IRS. The amount of Appeals dispositions may not be accurately tracked by the IRS Audit Information Management System.

…An additional percentage of the audits that are closed as undeliverable, meaning the taxpayers never had an opportunity to engage in the audit process because the audit notices could not be delivered to the taxpayer… These numbers indicate that the IRS may not be having sufficient communication with taxpayers to make full use of the audit process, which includes educating taxpayers.

For instance, each year saw over half of all assessments closed with a default assessment (meaning that the credit was denied because the taxpayer did not respond or stopped responding), making default assessments the primary type of audit closure. The number of default assessments was largest in FY 2010, with 63.7 percent of audits closed as a default assessment and smallest in FY 2014, with 58.6 percent closed as a default assessment.[25] Audits closed with a taxpayer in agreement with the outcome also stayed relatively consistent over the five years. The highest number of cases closed with taxpayer agreement occurred in FY 2010 and FY 2013, with 14.7 percent of cases closed in agreement. The lowest measurement for cases closed in agreement occurred in FY 2011, when there were 13.3 percent of the cases closed in agreement.[26] Audits closed with a no change status (meaning that following a review of documentation submitted by the taxpayer, the IRS agreed with the taxpayer's return) peaked in FY 2014 with 12.9 percent and the lowest measurement occurred in FY 2011 with 9.5 percent of the audits closed with no change.[27]

Each fiscal year there is an additional percentage of the audits that are closed as undeliverable, meaning the taxpayers never had an opportunity to engage in the audit process because the audit notices could not be delivered to the taxpayer. For the five fiscal years, an average of 11 percent of the cases were closed as undeliverable.[28] Overall, these numbers indicate that the IRS may not be having sufficient communication with taxpayers to make full use of the audit process, which includes educating taxpayers.

Figure 1.23.2 shows the outcome of closed audits for FY 2013. While a majority (65.2 percent) are full paid, approximately one-quarter remain open with a balance due remaining. Of those listed as currently not collectible (CNC), 23.4 percent were CNC hardship.[29] CNC hardship is a status that is used when the IRS determines that collection of the liability would leave the taxpayer unable to pay their basic living expenses.[30] Taxpayers in this category will still have their refunds offset unless they can request their refund prior to offset. This means that taxpayers whom the IRS has determined are unable to pay their outstanding liabilities may still full pay the liability because of offsets. Liabilities are more likely to be

25 In 2010 there were 474,024 audits and 301,818 resulted in a default assessment. In 2014, there were 435,639 audits and 255,286 resulted in a default assessment. IRS CDW, Audit Information Management System Closed Case Database.

26 In 2010, there were 474,024 audits and 68,185 were closed with taxpayer agreement. In 2011, there were 483,820 audits and 64,275 were closed with the taxpayer in agreement. *Id*.

27 In 2014, there were 435,639 audits and 56,193 were closed with no change. In 2011, there were 483,820 audits and 45,780 closed with no change. IRS CDW, Audit Information Management System Closed Case Database. Appeals closed 212 non-docketed EITC cases in FY 2012. This number totaled 196 in FY 2013, 174 in 2014, and 148 in FY 2015. Appeals did not track this information during FY 2010 or FY 2011. IRS response to TAS information request (Dec. 9, 2015). The IRS noted in its fact check response dated Dec. 16, 2015 that it considers no change cases with adjustment and certain other closures as agreed cases. Accordingly the IRS computation of its agreed cases is some percentage points higher and its computation of its no change rate is correspondingly some percentage points lower. By the IRS classification of disposal codes, FY 2014 has the highest percent of cases agreed at 21.5 percent.

28 FY 2010 had an undeliverable measurement of approximately nine percent, FY 2011 had approximately 12 percent, FY 2012 had a measurement of approximately 13 percent, FY 2013 had a measurement of approximately 12 percent, and FY 2014 had a measurement of approximately ten percent.

29 Individual Master File (IMF) as of cycle 201530, AIMS data, cases closed in FY 2013.

30 Internal Revenue Manual (IRM) 5.16.1.2, *Currently Not Collectible Procedures* (Jan. 1, 2015).

paid by refund offset than by other subsequent payments. In FY 2013, the IRS received approximately $93 million in subsequent payments but approximately $333 million from refund offsets.[31]

FIGURE 1.23.2, Status of EITC Audited Accounts, FY 2013 Audit Closures[32]

Category	Count	Percent
Full Paid	314,720	65.2%
Balance Due Remaining	120,941	25.0%
Installment Agreement	18,543	3.8%
Currently Not Collectible	28,709	5.9%
Total	**482,913**	**100.0%**

Internal Guidance That Encourages Acceptance of Alternative Documentation to Substantiate EITC Claims Will Help Taxpayers Eligible for the Credit

One practice that could benefit low income taxpayers is the acceptance of alternative documentation. The IRS has guidance for analyzing documentation submitted by taxpayers in EITC cases. In particular, IRM 4.19.14.5.4 provides IRS employees with a chart for analyzing EITC cases involving qualifying children.[33] However, the list provided is very narrow and does not reflect the types of documentation and methods of proof that may most likely be available or best-suited for taxpayers claiming the EITC. The current internal guidance also lacks specific instruction for tax examiners to consider alternative documentation.[34] In 2013, the National Taxpayer Advocate issued internal guidance to TAS employees related to EITC issues.[35] This guidance included a list of 50 alternative documents that could be used to substantiate an EITC claim.[36] While not exhaustive, it created a more flexible approach to analyzing documents in EITC cases.[37] The IRS team dedicated to improving the EITC audit process, of which TAS is a member, will address the issue of incorporating alternative documentation into internal guidance in FY 2016.

In 2005, the IRS studied the use of affidavits as part of the EITC Qualifying Child Residency Certification Study.[38] For the study, the IRS mailed documents to taxpayers (the test group) who had claimed the EITC with qualifying children in the previous tax year (TY), but for whom the IRS could not establish qualifying child residency through available data. The documents sent to the taxpayer explained the certification requirements, Form 8836, *Qualifying Child Residency Statement*, an affidavit form, and educational publications.[39] To certify his or her claim, the taxpayers in the study could submit any combination of documents described in Form 8836 (medical and school records, a letter on official letterhead,

31 IMF as of cycle 201526.

32 IMF as of cycle 201530. We could not determine the current status of approximately 175 cases.

33 IRM 4.19.14.5.4, *EITC Qualifying Children* (Jan. 1, 2015). IRS employees who are directed to IRM 4.19.14.5.6 for a list of acceptable documents to prove qualifying child. *See id*.

34 TAS, *Memorandum for Taxpayer Advocate Service Employees, Reissuance of Interim Guidance on Advocating for Taxpayers Claiming Earned Income Tax Credit (EITC) with Respect to a Qualifying Child* (Dec. 23, 2013).

35 *Id*.

36 *Id*.

37 TAS uses the Taxpayer Assistance Order (TAO) process and provides alternative documentation while advocating for taxpayers whose EITC claims were denied by the IRS. In FY 2014, TAS issued 24 EITC TAOs, of which the IRS complied with 21. In FY 2015, 10 EITC TAOs were issued and the IRS complied with nine. Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2014; Oct. 1, 2015).

38 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* 7 (Oct. 2005).

39 *Id*.

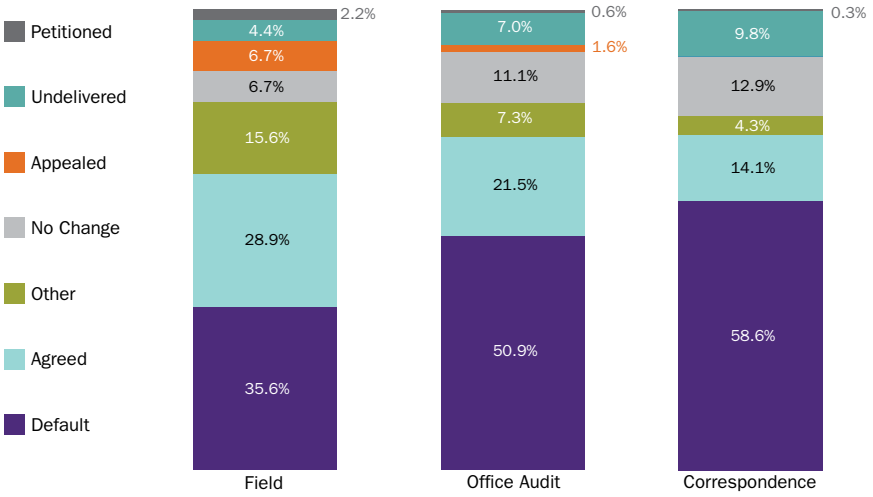
etc.) or the affidavit. The study found that affidavits had the highest rate of acceptance at 82 percent, compared to an overall acceptance rate of 64 percent for all document types.[40] The study concluded that this outcome was reasonable because affidavits had dedicated lines for all of the information, explaining "as long as the affidavit was filled out completely, it would contain all the required information to be accepted."[41]

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 EITC audit process has a fairly large non-response rate of over 40 percent.[42] Audits are not just about correcting a specific year's tax liability. Every audit provides an opportunity for the IRS to educate the taxpayer about errors on the return, so he or she becomes and remains compliant going forward. If the education is effective, taxpayers not only understand whether they are eligible to claim EITC in the audit year, but they can also remain compliant or avoid future noncompliance as their circumstances change.[43] By meeting the needs of low income taxpayers during the audit process, the IRS may improve the response rate and thus increase future compliance by educating more taxpayers.

FIGURE 1.23.3[44]

FY 2014 EITC Audit Dispositions by Type of IRS Examiner



40 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* 33 (Oct. 2005).

41 *Id*.

42 For FY 2014, the exact no response rate is 45.6 percent. This calculation includes 255,286 default assessments minus 99,067 default assessments that involved some taxpayer contact, bringing the total of default assessments with no taxpayer contact to 156,219. In addition, 42,490 cases involving undeliverable mail were then added, for a total of 198,709 cases with either a default assessment and no contact or undeliverable notices. That number divided by the total of 435,639 equals 45.6 percent and represents the portion of taxpayers who did not respond to the EITC audit. Audit Information Management System (AIMS) Closed Case Database.

43 National Taxpayer Advocate 2013 Annual Report to Congress 110.

44 AIMS Closed Case Database. Percentages may not total to 100 percent due to rounding. The examiner type is based on the AIMS employee code. It should be noted that field audits and office audits account for less than 400 of the EITC audits closed in FY 2014. We cannot determine if the selection of EITC cases for audit by different types of employees affects the disposition of the audit.

The audit outcome for a taxpayer appears to improve depending on the audit method and which type of IRS examiner handles the audit. Field audits, in which a revenue agent is assigned to the taxpayer's case, have the lowest default and undeliverable numbers. Field audits had a default closing in 35.6 percent of the cases and the audit was closed as undeliverable in 4.4 percent of the cases.[45] When compared to the average undeliverable rate for all audits above, field audits that result in an undeliverable status are approximately half as frequent. Cases worked in correspondence, which do not have an assigned employee, had a default rate of 58.6 percent and an undeliverable measurement of 9.8 percent.[46] These numbers may indicate that audit outcomes are improved when an assigned employee is working the case and it is not only based on a correspondence examination.[47]

Audits are not just about correcting a specific year's tax liability. Every audit provides an opportunity for the IRS to educate the taxpayer about errors on the return, so he or she becomes and remains compliant going forward.

The correspondence examination process is based on an exchange of documentation and not personal interaction. Under this system, even if the IRS does receive correspondence from the taxpayer, there will be missed educational opportunities. For example, if the taxpayer receives a request for substantiating documentation and does not understand the notice, he or she may send in incomplete or irrelevant documentation. Without an employee to speak with, the taxpayer will not learn what specifically is at issue and what specific documentation is needed. Thus, an otherwise legitimate claim may be denied or reduced in amount simply because the taxpayer needed an explanation of what is at issue and what is required, in terms he or she can understand.

The IRS National Research Program (NRP) recently conducted EITC audits in order to gather information about the nature of errors taxpayers made when claiming the EITC in TYs 2006 through 2008.[48] Focused taxpayer education is one component of the NRP audit that is not present in a correspondence exam.[49] NRP audits are worked by examiners "trained to make every accommodation to meet with taxpayers, to educate them about the necessary documentation for substantiating EITC eligibility, and to give them sufficient opportunity to obtain and supply the necessary information."[50] Nearly 95 percent of the NRP audits require a face-to-face meeting with an IRS examiner.[51] On the other hand, in the correspondence examination process, education of the taxpayer is not a focus.[52] As part of a study on enhanced taxpayer communication in 2013, TAS called taxpayers who had been assessed an

45 AIMS Closed Case Database through August 2015. It should be noted that field audits and office audits account for less than 400 of the EITC audits closed in FY 2014. We cannot determine if the selection of EITC cases for audit by different types of employees affects the disposition of the audit.

46 AIMS Closed Case Database through August 2015.

47 It should be noted that field audits and office audits account for less than 400 of the EITC audits closed in FY 2014. We cannot determine if the selection of EITC cases for audit by different types of employees affects the disposition of the audit.

48 IRS, Research, Analysis & Statistics (RAS), *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Aug. 2014). The NRP "seeks to increase public confidence in the fairness of our tax system by helping the IRS identify where compliance problems occur, so that the IRS can efficiently utilize its resources to address those problems." IRM 4.22.1.3(1) (Apr. 25, 2008).

49 For a general discussion of how the lack of an assigned employee in correspondence exam harms taxpayers, see National Taxpayer Advocate 2014 Annual Report to Congress 134-44.

50 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 8 (Aug. 2014).

51 *Id*. at 5.

52 Since correspondence exam does not assign cases to one employee, the focus in correspondence exam is to have taxpayer contact go to the next available employee instead of the employee working the case. This creates a system where the IRS employee answering the taxpayer's question may not be familiar with the taxpayer's issue or documentation. National Taxpayer Advocate 2014 Annual Report to Congress 139-40.

EITC liability in a correspondence examination and found that less than one-quarter learned that they were ineligible during the audit compared to almost one half after contacting TAS.[53]

If the IRS wants to reach the correct conclusion in *all* of its EITC audits and simultaneously promote future voluntary compliance, it should tailor its correspondence exam process to include interaction with the taxpayer and taxpayer education. Such an approach will increase EITC compliance and instill a sense of procedural justice into the audit process. One way the IRS can accomplish this is by assigning EITC correspondence exam cases to a single employee when the taxpayer responds with some information. That way, the employee can be charged with the same responsibility for educating the taxpayer as NRP auditors are.[54] This approach may reduce the number of EITC audits (which are already a disproportionately high percentage of all individual audits), however, the effectiveness of the audit in terms of ongoing compliance may even increase the indirect effectiveness of the audit.[55] Another approach involves the use of virtual face-to-face audits, whereby the taxpayer can make an appointment and meet with the auditor virtually. This technique captures the cost savings of a centralized audit group and the benefits of face-to-face communication, which enables the auditor to establish trust with the taxpayer and to identify when the taxpayer does not understand directions or is otherwise confused.

The IRS May Not Be Auditing the Group of EITC Returns Having the Most Non-Compliance, Thereby Diminishing the Effectiveness of IRS Efforts to Improve Future Compliance and Creating a Burden for Taxpayers

TAS analysis reveals the following issues with the way in which the IRS selects EITC cases for audit:

- The IRS relies on the Dependent Database (DDb) and does not build a workload selection model based on NRP data;
- Most NRP audits did not trip DDb rules, meaning the existing DDb rules may not be capable of capturing a complete sample of cases to audit; and
- The IRS is currently focusing on cases where the DDb rules for both residency and relationship are broken, and generally focusing only on the relationship component in these audits because it is the easiest basis for denial. Because residency is the eligibility requirement associated with three-quarters of the qualifying child errors, the IRS should consider more cases where the DDb rule for residency is the only rule broken, and also educate the taxpayer about the residency requirements when both rules are broken.

The IRS Relies on the DDb and Does Not Build a Workload Selection Model Based on NRP Data

Data from the NRP show how attributes of the EITC population and the complex eligibility rules impact compliance.[56] The NRP Individual Income Tax study is based on a multi-year random sample of federal individual income tax returns. As noted earlier, the NRP audit approach is better suited than the cor-

53 Unpublished results from *Enhanced Communication Study*, results on file with the National Taxpayer Advocate.

54 See National Taxpayer Advocate 2014 Annual Report to Congress 134-144 (Most Serious Problem: *Correspondence Examination: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*).

55 IRS FY 2014 Data Book Table 9a. The audit coverage rate for all individual returns is about 0.9 percent, while the coverage rate is about 1.6 percent for EITC returns. *See also supra* note 9 regarding the number of EITC audits.

56 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Aug. 2014). Unlike the IRS's typical EITC audits, NRP EITC audits have a response rate of about 85 percent when a qualifying child is involved. The response rate for operational EITC audits is under 60 percent. For more information on this topic, see National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 123-28.

respondence audit to accurately determine the audit results of the low income population by generally providing for in-person (instead of correspondence) audits. NRP data should be driving how the IRS selects EITC cases for audit, since it provides information about the sources of EITC noncompliance. Currently, however, Examination receives most of its EITC cases from the DDb.[57] In this program, returns are scored by comparing the return information against various business rules established by the IRS, with the highest-scoring returns selected for audits.

Most NRP Audits Do Not Trip DDb Rules

TAS analyzed NRP audits that broke DDb rules and found that in TY 2008, approximately 86 percent of the NRP cases with adjustments *did not* trip a DDb rule.[58] As mentioned above, the quality of the NRP data is quite high. The IRS should use this information to reevaluate its method of selecting cases for audit and improve on its ability to identify areas of noncompliance. The following figure shows the results from 2006 through 2008 NRP audits.

FIGURE 1.23.4[59]

NRP Audits Disallowing Some EITC That Broke DDb Rules

57 IRM 4.19.14.1(2) (Jan. 1, 2015).

58 The DDb data comes from a Business Object interface with the DDb. The NRP and closed audit information comes from the database of NRP data stored on the IRS CDW and from the AIMS also on the IRS CDW. The NRP data is a weighted sample. TAS used a weighting scheme which did not generally assign a weight to no response cases and cases selected for audit based on the DDb score. If the weights are recomputed to include these cases, about 80 percent of the returns where EITC was disallowed did not trip DDb rules. This percentage has also dropped in subsequent years, but is still about 70 percent. IRS fact check response (Dec. 16, 2015).

59 *Id*.

In other words, the IRS is concentrating its Earned Income Tax Credit (EITC) audit resources on taxpayers with a noncompliance issue that is relatively minor, compared to an issue associated with 75 percent of all EITC qualifying child errors. If the point of an audit is not just to score audit adjustments and create good statistics, but rather to educate taxpayers so they understand the rules and voluntarily comply in the future, then IRS EITC audit strategy is ineffective.

The IRS Should Consider More Cases Where the DDb Rule for Residency Is the Only Rule Broken

NRP data shows that approximately 75 percent of children claimed in error failed the residency test and only about 20 percent failed the relationship test.[60] TAS further analyzed DDb audits for TY 2012, and preliminary data show that approximately 70 percent of the returns selected for audit failed both the residency and relationship DDb audit rules. However, EITC returns with qualifying children that DDb indicates as not meeting the residency and relationship rules only comprise 23 percent of all returns that broke an EITC DDb rule.[61] TAS also found that only 11 percent of the audited returns broke the DDb rules for residency but not relationship for all children claimed, even though these returns represent about 31 percent of the returns that failed or partially failed a DDb test.[62] The data suggest that the IRS should focus some of its audit efforts on returns that have qualifying children with only residency issues, instead of primarily focusing on returns with qualifying children having both relationship and residency issues. In other words, the IRS is concentrating its EITC audit resources on taxpayers with a noncompliance issue that is relatively minor, compared to an issue associated with 75 percent of all EITC qualifying child errors. If the point of an audit is not just to score audit adjustments and create good statistics, but rather to educate taxpayers so they understand the rules and voluntarily comply in the future, then the IRS EITC audit strategy is ineffective.

Analysis of DDb Data Shows It Is Not Detecting Most Noncompliant Taxpayers

TAS also compared NRP data to DDb data. Preliminary results suggest that based on residency and relationship, most noncompliant taxpayers were not detected by the DDb. The NRP EITC study indicates that qualifying child errors are the most expensive, and account for at least 42 percent of the overclaims.[63] The NRP study involved a random sample of returns weighted to reflect the taxpayer population.[64] On the other hand, the IRS EITC audit population includes EITC returns that tripped the DDb rules. Of all returns in the NRP EITC study (which includes data from TYs 2006 through 2008) with at least one child failing EITC eligibility for residency, only approximately 25 percent also failed a DDb residency rule (for at least one child). Likewise, of all the returns in the NRP EITC study with at least one child failing EITC eligibility for relationship, only 28 percent also failed a DDb relationship rule.

60 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 22-23 (Aug. 2014).

61 The DDb data comes from a Business Object interface with the DDb. The NRP and closed audit information comes from the database of NRP data stored on the IRS CDW and from the AIMS also on the IRS CDW. In order for a taxpayer to claim a child with the EITC, that child must be a "qualifying child" as defined by IRC § 152(c). Two aspects of qualifying child include relationship and residency. To be related, the child must be the child of the taxpayer or a descendent of such a child or a brother, sister, stepbrother, stepsister of the taxpayer or a descendent of any such relative. IRC § 152(c)(2). This includes relationships by marriage and by law, such as adoptions. The residency test generally requires that the child live with the taxpayer for more than half of the tax year. IRC § 152(c)(1)(B). The DDb also selects returns for audit because the taxpayer is required to recertify EITC eligibility because of prior non-compliance with EITC eligibility rules.

62 The DDb data comes from a Business Object interface with the DDb. The NRP and closed audit information comes from the database of NRP data stored on the IRS CDW and from the AIMS also on the IRS CDW.

63 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* iv (Aug. 2014).

64 *Id*. at 5.

According to this NRP analysis, most returns failing EITC residency and relationship requirements are not being detected by the DDb rules. As noted above, the NRP study indicates that qualifying child errors are the most expensive EITC errors. NRP data also show that nearly three-quarters of the qualifying child errors stem from failing the residency requirements, while less than 25 percent result from relationship requirements.[65] However, the IRS does not have significant audit coverage of those who only fail EITC residency rules. By not selecting the most appropriate cases for audit, the IRS is missing many opportunities that could truly impact compliance, overlooks educational opportunities, and continues to allow erroneous claims to be filed.

CONCLUSION

A poorly designed EITC audit program results in lost opportunities to educate taxpayers and thus improve voluntary compliance, thereby reducing the improper payment rate. Under the present correspondence exam program, taxpayers whose EITC is correctly disallowed in one year do not learn about EITC eligibility rules and, as a result, may not claim the EITC in a future year in which they are eligible. Given that many low income taxpayers are not equipped to deal with the complexity of the EITC, the IRS should redesign its audit strategy to take into consideration how best to reach these taxpayers, how they respond to various types of outreach and education, how they prefer to receive service from the IRS, and how well they can comply with the EITC requirements and instructions.[66] The approach should foster engagement, valuing education and future compliance over assessed dollars.

The IRS should also consider how it selects EITC cases for audit so that the cases with the largest impact are being reviewed. Examination receives most of its EITC cases from the DDb. However, TAS research indicates that this approach alone may not identify the most appropriate cases for audit, which impacts EITC noncompliance.

65 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* v (Aug. 2014); *supra* note 60.

66 *See* National Taxpayer Advocate 2009 Annual Report to Congress 117.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct an EITC pilot with three different treatments: a regular correspondence examination, an office audit, and a correspondence examination with one auditor assigned. The pilot should measure the following: direct time on case, no response/drop-out rate, agreed to rate, audit reconsideration rate, and future compliance rate.
2. When an EITC taxpayer calls the IRS with information in response to an audit, one employee should be assigned to the taxpayer's case until it is resolved. If the taxpayer calls back, he or she could have the option to speak to the next available employee or wait for the assigned employee to call back. The IRS should hire employees with a social work background or train existing auditors to conduct the audits.
3. Use NRP data to design a formula for workload selection in addition to (or incorporated into) the DDb that will reach the audits with the most impact for taxpayer education and improvement to future compliance. This would include qualifying child errors that involve the residency test.
4. Revise the IRM with the list of additional documentation listed in the TAS IGM, as well as IRM updates about accepting alternative EITC substantiating documentation.
5. Publish and accept Form 8836, *Third Party Affidavit*, for purposes of substantiating the residency requirement for a qualifying child.
6. Collaborate with TAS to draft IRM guidance requiring correspondence examiners to adjust accounts for the childless worker credit when the taxpayer is ineligible for the EITC with children. This should be done automatically without requiring the taxpayer to request the 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

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) is one of the primary forms of public assistance for low income working taxpayers. To receive the benefits, the taxpayer must have earned income and file a tax return.[2] The determination of EITC eligibility is very complex and is difficult to navigate by taxpayers who are more likely to have lower literacy rates, to speak English as a second language, and to have a nontraditional family structure (where the child is not the biological child of the taxpayer claiming the credit). Fifty-five percent of returns claiming EITC were prepared by paid return preparers in tax year (TY) 2013.[3] Equally important, one IRS study showed unenrolled return preparers had the highest frequency and percentage of EITC overclaims, with 49 percent of those EITC returns containing an overclaim, and overclaims amounting to 33 percent of the total EITC claimed on those returns.[4]

Despite the involvement of so many paid preparers, the EITC suffers from a high noncompliance rate.[5] The problem of noncompliant return preparers contributing to the EITC error rate is well documented.

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The design of the EITC contains a phase-in, plateau, and phase-out state. Generally as the amount of income increases, the amount of EITC increases. At a certain point the EITC amount plateaus in relation to the amount of income (the taxpayer's income can increase while he or she receives the maximum amount of EITC) and then phases out as the EITC decreases with a decrease in income. In tax year (TY) 2014, taxpayers filing a joint return with three or more kids were ineligible for the EITC with earnings of $53,269. Rev. Proc. 2014-61, 2014-47 I.R.B. 860.

3 *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28, *Figure 4: Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage, Tax Years 2010-2013* (2015) (written statement of Nina E. Olson, National Taxpayer Advocate).

4 IRS, Research, Analysis & Statistics, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 26 (Aug. 2014). These numbers represent the lower bound estimates. This measure is likely to be low because it does not account for preparers who do not sign the returns they prepare. *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28 (2015) (written statement of Nina E. Olson, National Taxpayer Advocate).

5 The current improper payment rate of 27 percent has increased slightly from the improper payment rate in 2004, which measured 25 percent. Treasury Inspector General of Tax Administration (TIGTA), Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015).

In 2014, the Government Accountability Office (GAO) conducted 19 undercover visits to randomly selected tax preparer offices. Only two of the 19 tax returns showed the correct refund amount.[6]

Since 2002, the National Taxpayer Advocate has highlighted the need to protect taxpayers from non-compliant return preparers.[7] Based on a review of the IRS's existing EITC Return Preparer Strategy, the National Taxpayer Advocate has identified several concerns:

- Preparers who do not sign the returns and preparers who are the subject of complaints to the IRS Return Preparer Office (RPO) are not incorporated into the EITC Return Preparer Strategy;
- The public does not have access to the IRS's measures for evaluating the effectiveness of the strategy; and
- The EITC Return Preparer Strategy does not sufficiently focus on the unenrolled preparer population which, combined with a comprehensive public education campaign, is critical to improving EITC noncompliance.

Moreover, the EITC Return Preparer Strategy group does not partner with TAS, despite our extensive research into the role of return preparers in facilitating compliance, and our role as overseer of Low Income Taxpayer Clinics (LITC), which have keen insights and evidence of return preparer conduct with respect to EITC.

ANALYSIS OF PROBLEM

Background

The EITC and Refundable Credits Policy and Coordination (ERCPC) unit is charged with "developing and coordinating delivery of the EITC Return Preparer Strategy" within the Wage and Investment (W&I) Division.[8] ERCPC lists many key IRS partners and stakeholders, including W&I Chief Counsel, Criminal Investigation Refund Crimes, W&I Campus Compliance, W&I Research & Analysis (WIRA), the RPO, and TAS.[9] However, the IRS has not involved TAS in the development or implementation of the EITC Return Preparer Strategy.

6 GAO, *Paid Tax Preparers: In a Limited Study, Preparers Made Significant Errors* 9 (Apr. 8, 2014). The National Consumer Law Center also conducted similar "mystery shopper" testing in 2010 and found "incompetence and fraud" in about 30 percent of the tests. *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 39 (2014) (statement of Chi Chi Wu, staff attorney, National Consumer Law Center).

7 National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78; National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remains Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2008 Annual Report to Congress 504-12 (Most Litigated Issue: *Accuracy-Related Penalty Under Internal Revenue Code Sections 6662(b)(1) and (2)*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2005 Annual Report to Congress 223-37 (Most Serious Problem: *Regulation of Electronic Return Originators*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers); Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 7 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

8 Internal Revenue Manual (IRM) 1.1.13.6.4.2(3) (Oct. 7, 2013).

9 IRS response to TAS information request (June 24, 2015). Though TAS is listed on the response as a stakeholder, it has not been included in any meetings since inception of the EITC Return Preparer Strategy.

Prior to fiscal year (FY) 2012, the EITC Return Preparer Strategy primarily focused on treating preparers through methods described below after the filing season. Beginning in 2011, the IRS implemented a "real time" preparer intervention program. Instead of waiting until the end of the filing season to identify and treat preparers, preparers are also scored on a daily basis and treatments are administered in real time.[10] Once prior year compliance activities conclude and the analysis is complete, the Refundable Credits Administration (RCA) office, WIRA, and Office of Compliance Analytics (OCA) meet to score and select preparers for the next fiscal year's pre-filing season treatments.[11] Once the filing season starts, filing season treatments begin and preparers whose scores meet the threshold and who have a given volume of EITC returns prepared are selected daily for the filing season treatments.[12] The scoring is based on four criteria that relate to breaking a Dependent Database (DDb) rule related to the amount of the EITC relative to the number of qualifying children or a DDb rule related to disabled qualifying children.[13]

The EITC Return Preparer Strategy Office says that it is "always striving for improvement in all areas of the program" by implementing prior year lessons and testing new ideas.[14] The EITC Return Preparer Strategy uses a "test and learn" approach that involves experimenting with different combinations of new and traditional compliance tools that are reviewed on an annual basis.[15] For instance, in its FY 2015 annual report, the Strategy described an iterative "pre-filing season treatment delivery process" that increased the contact rate from approximately 70 percent to nearly 95 percent.[16]

The EITC Return Preparer Strategy uses various tools at its disposal for preparers of questionable EITC claims, referred to as "treatments."[17] Preparers are identified in the pre-filing season and, if there are no signs of improvement, then more intensive treatment continues into the filing season.[18] Treatments include:

- *Reaching out to preparers via letter and phone contact* – letters are sent both during the pre-filing season and filing season as a warning and to educate preparers;
- *"Knock and talk" visits* – educational visits conducted by an SB/SE agent and a special agent from Criminal Investigation (CI);
- *Visits and audits for preparer due diligence* – audits of high risk preparers conducted by SB/SE employees to ascertain compliance with due diligence requirements under Internal Revenue Code (IRC) § 6695(g);[19] and

10 IRS response to TAS information request (June 24, 2015).

11 IRS response to TAS information request (Oct. 21, 2015). These meetings occur in mid-summer and the pre-filing season activities generally start on October 1. *Id*.

12 *Id*.

13 IRS response to TAS information request (June 24, 2015). The DDb addresses non-compliance relevant to the EITC and other tax benefits related to the dependency and residency of children. The IRS claims the DDb consistently applies the tax laws to a return claiming EITC as well as other tax issues, such as dependent exemptions, filing status, Child and Dependent Care Credit, Child Tax Credit, and education benefits, are addressed concurrently. IRM 4.19.27.2.3, *Dependent Database (DDb)* (Mar. 19, 2015). However, it is possible that a return could break a DDb rule but the taxpayer could still be eligible for the EITC. *See The Public Does Not Have Access to the IRS's Measures for Evaluating the Effectiveness of the EITC Return Preparer Strategy*, *infra*.

14 IRS response to TAS information request (June 24, 2015).

15 *Id*.

16 WIRA, *Fiscal Year 2015 EITC Return Preparer Analysis Summary* 2 (June 15, 2015).

17 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

18 *Id*.

19 IRS response to TAS information request (June 24, 2015).

- *Injunctions against paid preparers* – the Department of Justice (DOJ) may seek an injunction against a preparer, which prevents that individual from "engaging in specified misconduct or from preparing tax returns for others."[20]

For the purpose of the EITC Return Preparer Strategy, an EITC preparer is a return preparer who files 25 or more EITC returns.[21] All preparers who meet this definition are scored. Based on this score, the preparer may receive a compliance treatment.[22] Allocation of resources and geographical limitations are also considered when determining treatments.[23]

Reaching Out to Paid Tax Preparers by Letter

Figure 1.24.1 shows the types and number of letters sent to preparers for FYs 2013 through 2015.

FIGURE 1.24.1, Pre-Filing and Filing Season Education and Compliance Letters for FYs 2013–2015[24]

Letter Number	Type	FY 2013	FY 2014	FY 2015
Pre-Filing				
4833	Compliance	10,673	10,892	7,261
4833-A	Educational	n/a	n/a	8,473
5138	Compliance	n/a	n/a	1,734
5025-C	Educational	985	2,856	479
5025-D	Educational	n/a	1,351	572
5025 (no alpha)	Educational	966	994	644
5025-Q	Educational	953	522	2,182
Filing				
4858	Compliance	1,866	2,272	3,796
5138	Compliance	736	867	1,015
5364/Alert	Missing Form 8867 Letter & e-File Alert	6,667	6,526	15,935
Total Number Sent		**22,846**	**26,280**	**42,091**

Pre-filing season letters are sent to preparers who prepared questionable EITC returns during the previous year. Filing season letters are sent to preparers whose due diligence compliance does not improve while the filing season is underway.[25] Preparers who do not receive their pre-filing season letter because it was

20 *See* Dep't of Justice, *Program to Shut Down Schemes and Scams*, *available at* http://www.justice.gov/tax/injunctions.htm. The DOJ can also pursue criminal prosecution. Since this is not an area worked by the EITC Preparer Strategy, it will not be covered in this discussion.

21 This amount is through cycle 26 of the current tax year. An EITC return is defined as a tax return "with at least one dollar claimed and/or received in EITC based on at least one qualifying child for a tax year." IRS response to TAS information request (June 24, 2015).

22 IRS response to TAS information request (June 24, 2015).

23 *Id*. By limiting compliance treatments only to preparers who prepare 25 or more returns, the pool of preparers who do not sign returns will not receive a compliance treatment, an issue discussed in more detail below.

24 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

25 IRS response to TAS information request (June 24, 2015).

undeliverable, will receive a follow up phone call.[26] Undelivered letters do pose a problem for an effective treatment. In FY 2012, the non-delivery rate for Letter 4833 was 24 percent and the rate rose to 36 percent in FY 2014.[27] The Strategy has attempted to resolve this by recommending such things as the use of an internal database to reduce outdated addresses and sending uncertified letters.[28]

When developing educational and compliance letters, the IRS should look to the concept of "responsive regulation," which is explained by Australian researcher Valerie Braithwaite to mean that regulators, such as the IRS, should be "responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required."

Currently, the EITC Return Preparer Strategy intends to use educational letters to inform less egregious preparers of due diligence requirements and possible consequences of filing inaccurate EITC returns.[29] Compliance letters are intended to emphasize the penalty and consequences that may result from returns with EITC errors.[30] There are opportunities to make these letters more effective, as described in more detail below.

When developing educational and compliance letters, the IRS should look to the concept of "responsive regulation," which is explained by Australian researcher Valerie Braithwaite to mean that regulators, such as the IRS, should be "responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required."[31] Braithwaite uses a "regulatory pyramid" that includes the least intrusive actions at the bottom and most intrusive at the top.[32] The idea is that taxpayers generally will comply at the least intrusive step but if not, more intrusive actions can be taken. Applying this theory to the Strategy's current letters demonstrates some deficiencies.

For instance, Letter 4858, *Return Preparer Filing Season - 2015*, a compliance letter, informs preparers that a review of current year returns filed by the preparer "indicates you may have prepared inaccurate returns for your clients," but does not provide information on the exact nature of the errors being made by the preparer, thus limiting its effectiveness in getting preparers to avoid these errors in the future.[33] There is no reason why "compliance" letters should not be educational. In fact, to get preparers to modify their behavior, the letter should inform the preparer of the errors they are making.

The 5025 series of letters informs the preparer of the reason for noncompliance in a very general manner. If the primary issue identified is questionable income and expenses on Schedule C, *Profit or Loss from Business*, the preparer may receive Letter 5025-C, *You May Have Prepared Inaccurate EITC Returns with Self-Employment Income*. When the primary issue identified involves claiming children who are permanently or totally disabled, the preparer may receive Letter 5025-D, *You May Have Violated Tax Law By Preparing Inaccurate EITC Returns*. If the primary issue is claiming qualifying children, the preparer may receive Letter 5025-Q, *You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying*

26 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

27 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 29 (June 20, 2014). The primary reasons for being undeliverable include the letter being unclaimed and the address being outdated. *Id.*

28 *Id.* at 30.

29 IRS response to TAS information request (Nov. 5, 2015).

30 *Id.*

31 Valerie Braithwaite, *Responsive Regulation and Taxation: Introduction*, 29 Law & Pol'y 3, 4 (Jan. 2007).

32 *Id.*

33 IRS, Letter 4858, *Return Preparer Filing Season – 2015* (Nov. 2015).

The lack of distinction between educational and compliance letters indicates the IRS does not have a comprehensive strategy with respect to letters. In most instances the IRS has not designed the letters to make clear what behavior the preparer should change going forward. It also has not designed the letters so that successive letters make clear to the preparer that the stakes for noncompliance are being raised.

Children. However, the preparer will not learn what particular error he or she is making.

There also appears to be little difference between compliance and educational letters. Without a clear distinction between education and compliance, preparers may not realize they are receiving a communication meant to ramp up their regulation (and consequences). For instance, Letter 4833 was the "compliance" letter most frequently mailed during the pre-filing season in FY 2015. The language in Letter 4833 is similar in many aspects to Letter 4833-A, which was the primary "educational" letter sent during the filing season in FY 2015. The opening section of both letters informs the preparer that the IRS has reviewed returns they prepared and the review "indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax laws could result in penalties and other consequences for you as the paid preparer and for your clients." Letter 4833-A, the educational letter, contains additional information to explain to the preparer that if inaccurate returns continue to be prepared, the preparer may face a penalty or an audit and his or her clients could face repercussions.

Figures 1.24.2 and 1.24.3 compare the language in Letters 4833 and 4833-A.

FIGURE 1.24.2[34]

IRS Letter 4833, *EITC Return Preparer Pre-Filing Season Alert,* page 1 and Letter 4833-A, *EITC Tax Return Preparer Alert*, page 1

Department of the Treasury
Internal Revenue Service
NDC/EITC
1201 N. Mitsubishi Motorway
Bloomington, IL 61705

Date:
12/21/2015
Contact telephone number:
855-379-0440 (toll free)

Dear [Name]:

Our review of the 2013 tax returns you prepared that claimed the Earned Income Tax Credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and for your clients.

Paid return preparers' responsibilities

- Know the tax law
- Inform clients of EITC requirements so you can determine if the taxpayer qualifies for the EITC
- Meet all four due diligence requirements before preparing an EITC claim for a taxpayer
  - Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, and submit it with every EITC return you prepare
  - Complete an EITC worksheet
  - Question the taxpayer if any information appears to be incorrect, inconsistent or incomplete and document your questions and the taxpayers' responses
  - Keep all required records

Paid return preparers who prepare inaccurate EITC returns

Preparers who don't meet due diligence requirements on EITC returns face a penalty of $500 per return.

Additional information on EITC requirements including EITC due diligence

- Review the enclosed Publication 4687, *EITC Due Diligence*
- Visit our website at **www.eitc.irs.gov/rptoolkit/main/**
- Call the toll-free number listed at the top of this letter
- Visit **www.eitc.irs.gov/EITCCentral/SP_L4833.doc** to view this letter in Spanish

Letter 4833 (Rev. 8-2014)
Catalog Number 58627F

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax laws could result in penalties and other consequences for you as the paid preparer and for your clients.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.
  3. Question the client if any information appears to be incorrect, inconsistent, or incomplete and document your questions and the client's responses. Failure to adequately question the client and document the responses is the most common reason we assess penalties.
  4. Keep all required records, including copies of any documents you relied upon to determine eligibility for, or the amount of, EITC.

Paid preparers who prepare inaccurate EITC returns:

- May face $500 penalty per return if they can't prove they met their EITC due diligence requirements.
- May receive a due diligence audit; have your and/or your firm's e-filing privileges suspended or terminated; or may be referred to the Department of Justice or IRS Criminal Investigation.

Letter 4833-A (Rev. 9-2015)
Catalog Number 67183W

34 IRS, Letter 4833, *EITC Return Preparer Pre-Filing Season Alert* (Aug. 2014); IRS, Letter 4833-A, *EITC Tax Return Preparer Alert* (Sept. 2015).

FIGURE 1.24.3[35]

IRS Letter 4833, *EITC Return Preparer Pre-Filing Season Alert*, page 2 and Letter 4833-A, *EITC Tax Return Preparer Alert*, page 2

We will continue to monitor the EITC returns you prepare. If the accuracy of these EITC returns does not improve, you may be subject to special follow-up procedures, including the possibility of an on-site audit.

Thank you for your cooperation.

Sincerely,

Michael C. Beebe
Deputy Director
Return Integrity & Compliance Services

Enclosures:
Publication 4687

Letter 4833 (Rev. 8-2014)
Catalog Number 58627F

Your clients:

- May be audited after we issue their refunds. If we determine your clients don't qualify for the EITC, they must repay the overpayments, plus interest.
- May be unable to claim the EITC for 2 years if the claim was due to reckless or intentional disregard of the EITC rules, or 10 years if the claim was due to fraud.

For additional information:

- Review Publication 4687, *EITC Due Diligence Brochure,* at www.irs.gov/formspubs.
- Visit our website at www.eitc.irs.gov and click on "Tax Preparer Toolkit."
- Visite www.eitc.irs.gov e ingrese las palabras claves "Letter 4833-A(SP)" para leer esta carta en español.

We will continue to monitor future EITC returns you prepare to ensure you're meeting your EITC due diligence requirements.

This letter is for your information only. You don't need to respond.

If you have questions, you can contact us via e-mail at the address listed above. For security purposes, don't include any client information if you contact us by e-mail. Include your telephone number and the hours we can reach.

Please note that we're unable to provide you with the specific returns that appear to be questionable.

Sincerely,

Steven C. Klingel
Director, Refundable Credits
Policy & Program Management

Letter 4833-A (Rev. 9-2015)
Catalog Number 67183W

35 IRS, Letter 4833, *EITC Return Preparer Pre-Filing Season Alert* (Aug. 2014); IRS, Letter 4833-A, *EITC Tax Return Preparer Alert* (Sept. 2015).

In order for this correspondence stage of the EITC Return Preparer Strategy to be effective, there should be a distinct difference when the preparer receives a compliance letter after receiving an educational letter. Letter 5138, a compliance letter, comes closest to accomplishing this goal. It informs the preparer that some of their clients are being audited for their EITC claims and reminds the preparer that "failure to comply with the due diligence requirements when preparing client returns for EITC claims can adversely affect you and your clients."[36]

Letter 5364 is not categorized as either educational or compliance. This letter informs the preparer that he or she failed to attach Form 8867, *Paid Preparer's Earned Income Credit Checklist*, and may be subject to penalties and other actions.[37] Most importantly, it provides the preparer with a list of incomplete returns. Thus, the letter warns the taxpayer of *specific* consequences for failing to comply with his or her *specific* obligations under the law, and alerts the preparer to *specific* returns the IRS considers incomplete. This gives the preparer clear information with which to modify behavior; moreover, failure to modify behavior in the face of such information and warning is a good indicator that the preparer is negligent. This would set up the next stage of the compliance strategy, namely Due Diligence penalties. However, it will only be effective if the IRS follows up with those preparers who ignore the letter.

The lack of distinction between educational and compliance letters indicates the IRS does not have a comprehensive strategy with respect to letters. In most instances the IRS has not designed the letters to make clear what behavior the preparer should change going forward. It also has not designed the letters so that successive letters make clear to the preparer that the stakes for noncompliance are being raised.

As described above, the IRS will send a pre-filing season letter to a preparer based on the previous year's returns.[38] Additional letters are sent if the preparer does not improve.[39] It was not possible for TAS to determine precisely how the IRS determined which letters would be sent each year. TAS assumes a process is in place since the approach taken between FYs 2013 and 2015 has changed. A TAS review of unpublished EITC Return Preparer Strategy reports shows that the Strategy does conduct reviews that cover distinct issues related to various letters. However, TAS has not been able to locate a year-to-year review of the effectiveness of all letters, or any analysis of whether single letters or a sequence of letters are more or less effective in improving EITC compliance. Without such an analysis, it is impossible to determine the effectiveness of the IRS's EITC letter strategy.

Due Diligence Requirements

Congress has recognized the role that paid preparers play in EITC compliance by imposing a penalty on preparers if they fail to comply with due diligence requirements.[40] IRC § 6695(g) provides that any tax return preparer who files a return or claim of refund involving the EITC and who fails to comply with due diligence requirements, will be liable for a penalty of $500 for each failure.[41] To meet the due diligence requirements, the preparer must complete Form 8867, *Paid Preparer's Earned Income Credit*

36 IRS, Letter 5138, *Return Preparer EITC Client Audit Notification* (Sept. 2015).

37 IRS, Letter 5364, *Warning to EITC Return Preparers - Missing Forms 8867* (Dec. 2015).

38 IRS response to TAS information request (June 24, 2015).

39 *Id*.

40 IRC § 6695(g). This duty also extends to determining the correct amount of credit allowed. *Id*. Recently, a law was enacted which would require the IRS to conduct a study of the effectiveness of the return preparer due diligence requirements on EITC claims (in addition to Child Tax Credit and American Opportunity tax credit claims). Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 § 207 (2015).

41 The United States-Korea Free Trade Agreement Implementation Act, Pub. L. No. 112–41, § 501, 125 Stat. 428, amended IRC § 6695(g) by increasing the amount of the penalty from $100 to $500 for returns filed after December 31, 2011.

Checklist, and include it with the return.[42] The form is to be completed based on information provided by the taxpayer or "otherwise reasonably obtained" by the preparer.[43] TAS first recommended requiring a signed Form 8867 be attached to each tax return back in 2003.[44] The IRS finally adopted this recommendation for tax returns filed after December 31, 2011.[45]

To meet the knowledge requirement on Form 8867, the preparer must attest that he or she did not know or have reason to know that any information he or she relied on to determine eligibility for the EITC (and the amount of credit) is incorrect. The preparer is instructed to not ignore implications of any information provided and to ask questions if any of the information provided seems to be "incorrect, inconsistent, or incomplete."[46]

"Knock and Talk" Visits

A more advanced treatment for noncompliance attributable to a return preparer is the "knock and talk" visit. This treatment consists of an educational visit by a team made up of a revenue agent and a criminal investigator.[47] During these visits the IRS employees discuss EITC laws and due diligence requirements.[48] As shown in figure 1.24.4, the number of Knock and Talk visits has decreased from 109 in FY 2013 to 94 in FY 2015.

FIGURE 1.24.4, EITC Preparer Compliance Treatments, FY 2013–2015[49]

	FY 2013	FY 2014	FY 2015
Preparer Penalty Cases			
Due Diligence Audits	734	601	815
Missing Form 8867	771	224	130
Number of Returns Resulting in Proposed Preparer Penalties			
Due Diligence Audits	35,886	51,034	62,914
Missing Form 8867	26,655	5,688	4,191
KTV and DDV Conducted			
Due Diligence Audits	867	736	956
Knock and Talk Visits	109	96	94

Audits of Preparer Due Diligence

As mentioned above, IRC § 6695(g) provides that any tax return preparer who files a return or claim of refund involving the EITC and who fails to comply with due diligence requirements, will be liable for a

42 Treas. Reg. § 1.6695-2.

43 *Id.*

44 National Taxpayer Advocate 2003 Annual Report to Congress 272. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 56.

45 Treas. Reg. §§ 1.6695-2(b)(1) and 1.6695-2(e).

46 IRS Form 8867, *Paid Preparer's Earned Income Credit Checklist* 3 (2013).

47 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

48 *Id.*

49 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

penalty of $500 for each failure. Beginning in FY 2013, the IRS also began proposing penalties for EITC returns submitted without Form 8867, *Paid Preparer's Earned Income Credit Checklist*.[50]

The EITC Return Preparer Strategy includes audits on preparers' adherence to due diligence requirements. When the examiner determines that the preparer did not comply with the due diligence requirements, the due diligence penalty is assessed.[51] Figure 1.24.4 shows that the number of returns resulting in a proposed penalty has increased from 35,886 in FY 2013 to 62,914 in FY 2015.

The Treasury Inspector General for Tax Administration (TIGTA) conducted a review of due diligence audits in 2010. Its findings highlighted several areas for improvement, including inadequate case documentation and potentially ineffective reviews by group managers.[52] The IRS reports that case reviews are conducted annually to identify areas of improvement and training materials are revised to address problem areas.[53] One example is training material for SB/SE examiners covering EITC due diligence visits, which emphasized the need for adequate workpapers to support the conclusions in the case.[54]

When compared to Knock and Talk visits, a due diligence audit is more burdensome for both the IRS and the preparer. According to the idea of "responsive regulation," the Strategy generally should apply the less burdensome approach first. However, the Strategy has reduced the amount of Knock and Talk visits while increasing due diligence audits. An internal review of the Strategy's annual reports shows that the IRS annually tracks the "effectiveness" of each treatment. However, as discussed in more detail below, the IRS's measures of "effectiveness" may not be the best ones for tracking preparer compliance. Before the Strategy decides to forego a less intensive form of treatment, it should fully study long term preparer compliance associated with each treatment to ensure it is efficiently achieving a change in preparer behavior.

Tracking EITC Return Preparer Improvement After Treatment

The EITC Return Preparer Strategy maintains a database of every preparer who has received a treatment (or attempted treatment) since FY 2012.[55] The progress of individual preparers does not appear to be the emphasis when measuring the change in tax return preparer behavior. In order to quantify the benefit of treatments, WIRA applies the same four criteria used in the scoring process.[56] WIRA compares the change in performance of a control group with that of the treated preparers from one filing season to the next.[57] The difference in the year-to-year change in performance between the two groups is attributed to the treatments.[58] This analysis is conducted on each treatment type to determine its effectiveness.[59]

One concern with this approach is that once in the treatment system, not all preparers continue to be tracked. While the EITC Return Preparer Strategy maintains that it monitors all preparers who receive treatment, this monitoring only applies if the preparer continues to show up as a preparer. An

50 IRS response to TAS information request (June 24, 2015).

51 Preparers have the right to appeal a proposed penalty assessment. IRM 20.1.6.19.1, *Pre-Assessment Appeal Rights—IRC 6694, IRC 6695, IRC 6707A, and IRC 6713* (May 16, 2012). Between TYs 2008 and 2013, Appeals abated approximately $1.7 million in penalty assessments. IRS response to TAS information request (Dec. 2, 2015).

52 TIGTA, Ref. No. 2010-40-116, *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* 10 (Sept. 14, 2010).

53 IRS response to TAS information request (June 24, 2015).

54 IRS response to TAS information request (Oct. 21, 2015).

55 *Id.*

56 *Id.*

57 The control group is randomly assigned amongst the preparers in each treatment stream. *Id.*

58 *Id.*

59 *Id.*

unscrupulous preparer may "go underground" once they receive a high level of treatment. Such a preparer would no longer be tracked by the EITC Return Preparer Strategy. While it may be resource intensive, the EITC Return Preparer Strategy should continue to track all preparers who have received treatment while introducing new preparers each year. As discussed in more detail below, the EITC Return Preparer Strategy should not just focus its measure of success on return on investment and dollars saved, but actual long term improvement in preparer compliance.

Given the Stagnant EITC Improper Payment Rate, Several Areas of the EITC Return Preparer Strategy Can Be Revised to Improve Its Effectiveness

As mentioned above, the percentage of EITC improper payments remains practically unchanged over the last decade.[60] The current improper payment rate of 27 percent has increased slightly from the improper rate in 2004, which measured 25 percent.[61] Based on a review of the existing EITC Return Preparer Strategy, the National Taxpayer Advocate has identified several concerns discussed in detail below.

Preparers Who Do Not Sign the Returns and Preparers Who Are the Subject of Complaints to the IRS Return Preparer Office Are Not Incorporated into the EITC Return Preparer Strategy

The EITC Return Preparer Strategy currently only reaches the pool of paid tax return preparers who prepare more than 25 EITC returns that contain errors.[62] Not all errors are committed by a known preparer. As Senate Finance Committee Chairman Wyden points out: "[i]n some egregious cases, preparers calculate a taxpayer's refund in person and skip the line that shows who did the work. Then, after the taxpayer leaves, the preparer falsifies the math to boost the refund, files the return, and pockets the difference."[63] In this situation, since the preparer did not sign the return, the preparer would not receive treatment through the EITC Return Preparer Strategy but might be discovered through a complaint by a taxpayer or other party (including IRS employees) to the IRS.

In FY 2014, the EITC Return Preparer Strategy identified 1,152 preparers misusing preparer identification.[64] [redacted]

60 For information on how the EITC audit process is not effectively reducing the improper payment rate, see Most Serious Problem: *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*, *supra*.

61 TIGTA, Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015). The lowest improper payment measurement was 23 percent, which occurred in 2012. *Id*.

62 IRS response to TAS information request (June 24, 2015).

63 *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 2 (2014) (statement of Ron Wyden, Chairman, Committee on Finance).

64 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 2 (June 20, 2014).

65 [redacted] The IRS has identified the information discussed is this paragraph as "official use only" and therefore we are not at liberty to disclose it.

66 [redacted] The IRS has identified the information discussed in this paragraph as "official use only" and therefore we are not at liberty to disclose it.

In 2012, the RPO began sharing referrals with the ERCPC.[67] The ERCPC independently identified and treated only 37 percent of the referred preparers, finding that most did not meet the program's selection criteria.[68] Given limited resources, using referrals as a criterion for compliance treatment could be effective in identifying noncompliant preparers, particularly those who are operating invisibly and highly likely to be harming taxpayers. If someone, either a taxpayer, a preparer, or an internal IRS employee, refers a preparer, that should be a selection criterion heavily weighted for at least an education, if not compliance, treatment.

The Strategy currently is not equipped to address preparers who do not sign returns. [redacted] However, the Strategy is aware of the impact these preparers have on EITC noncompliance. In its 2014 annual report, the Strategy reported developing a systemic methodology to identify "ghost preparers" as part of its long term strategic plan.[70] The report stated that the effort required would be high but the potential impact would also be high.[71]

Given limited resources, using referrals as a criterion for compliance treatment could be effective in identifying noncompliant preparers, particularly those who are operating invisibly and highly likely to be harming taxpayers. If someone, either a taxpayer, a preparer, or an internal IRS employee, refers a preparer, that should be a selection criterion heavily weighted for at least an education, if not compliance, treatment.

A possible method for identifying ghost preparers is to track preparers after they fall off the radar and are no longer tracked. The EITC Return Preparer Strategy could obtain a preparer inventory listing, which shows every return prepared by a preparer, for the year before the preparer falls off the radar.[72] The EITC Return Preparer Strategy could review that list and compare it to some or all of the current year returns. If there is a pattern of similar mistakes on the current year returns, or if a large portion of the current taxpayers now appear to prepare their own returns, the EITC Return Preparer Strategy may want to interview the taxpayers to see who prepared their returns. If there is a trend with the new returns, it is possible that the preparer has gone underground.

The EITC Return Preparer Strategy could partner with SB/SE and its Return Preparer Program (RPP) to identify the preparers who fall off the radar.[73] Under the RPP, the IRS can create program action cases (PAC), which are "preparer investigations where clients of questionable preparers are examined to determine whether preparer penalties and/or injunctive actions against the preparers are warranted."[74] PACs are limited to "situations where information indicates a return preparer has engaged in a widespread practice of making material errors that demonstrates intentional misconduct or clear incompetence in preparing tax returns."[75] This type of situation would capture the

67 IRS response to TAS information request (June 24, 2015).

68 *Id*.

69 [redacted] The IRS has identified the information discussed in this paragraph as "official use only" and therefore we are not at liberty to disclose it.

70 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 10 (June 20, 2014).

71 *Id*.

72 Return preparer coordinators have access to listings of returns prepared by preparers using an internal IRS database. Perhaps the EITC Return Preparer Strategy would have to partner with such coordinators to obtain this listing if they cannot obtain it on their own. IRM 20.1.6.6, *Program Action Cases Overview* (Sept. 10, 2013).

73 For information on the RPP, see IRM 4.1.10.1, *Overview of Return Preparer Program* (Jan. 14, 2011).

74 IRM 4.1.10.3, *Program Action Cases Overview (PAC)* (Jan. 14, 2011).

75 IRM 4.1.10.3(2) (Jan. 14, 2011).

actions of an unscrupulous EITC return preparer. In fact, the EITC Due Diligence program is already a priority for the RPP.[76]

The Public Does Not Have Access to the IRS's Measures for Evaluating the Effectiveness of the EITC Return Preparer Strategy

The ERCPC issues an annual report that evaluates the success of the EITC Return Preparer Strategy but these reports are not available for public inspection.[77] In fact, since the population of preparers receiving treatment constantly changes, the IRS looks at the return on investment of the program to measure success.[78] Return on investment (and therefore success of the program) is measured by the amount of EITC bad returns and dollars saved divided by the cost of treatment.[79] The cost of each treatment is easy to ascertain. However, as discussed below, the measurement for "bad" EITC returns and dollars saved may not be accurate. Since FY 2012, the EITC Return Preparer Strategy estimates it has protected $2.4 billion in EITC claims.[80] However, because there is no public report that discloses or describes the return on investment for the EITC Return Preparer Strategy, the public has no way of ascertaining the accuracy of IRS claims of success or the overall effectiveness of the IRS EITC Return Preparer Strategy. As discussed below, the IRS's methodology likely overstates the program's revenue protection amount.

…because there is no public report that discloses or describes the return on investment for the Earned Income Tax Credit (EITC) Return Preparer Strategy, the public has no way of ascertaining the accuracy of IRS claims of success or the overall effectiveness of the IRS EITC Return Preparer Strategy.

An erroneous EITC return is defined as a return that contains the same errors used in the scoring process.[81] If the return breaks one of the filters in the scoring process, it is deemed a "bad" return and any credit dollars attributed to it is considered revenue protected.[82] Thus, if a return is categorized as potentially erroneous, both the entire amount of EITC claimed as well as the entire amount of Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC) claimed are identified as potentially erroneous.[83] However, these returns do not undergo an audit by the IRS prior to this designation. As a result, there may be instances where a return deemed erroneous is actually accurate or at least partially accurate. For instance, there could be a return where the taxpayer claimed a child who is not a qualifying child, but the taxpayer is still eligible for the childless EITC. Alternatively, the child could be a "qualifying relative" of the taxpayer, which could be determined by reviewing documentation in an audit.[84] There could also be an issue with identify theft that affected a taxpayer's initial eligibility.

76 IRM 4.1.10.1.2, *Return Preparer Program Priorities* (Jan. 14, 2011).

77 IRS response to TAS information request (June 24, 2015).

78 Minutes for meeting via telephone between TAS employees and IRS employees responsible for implementation of the EITC Return Preparer Strategy (Nov. 20, 2015) (on file with the National Taxpayer Advocate).

79 *Id*.

80 This amount does not include the additional revenue generated from audits and due diligence visits but does include money protected for Child Tax Credit and Additional Child Tax Credit claims. IRS response to TAS information request (June 2, 2015). Since FY 2012, the EITC Preparer Strategy has a total program value of $1.7 billion. IRS response to TAS information request (Oct. 20, 2015); IRS, *FY 2015 EITC Return Preparer Strategy Analysis Summary, Executive Summary* (June 2015).

81 IRS response to TAS information request (Oct. 21, 2015).

82 Minutes for meeting via telephone between TAS employees and IRS employees responsible for implementation of the EITC Return Preparer Strategy (Nov. 20, 2015) (on file with the National Taxpayer Advocate).

83 IRS response to TAS information request (Oct. 21, 2015).

84 For information on what constitutes a qualifying relative, *see* IRC § 152(d). In many aspects, the documentation needed to prove eligibility for qualifying relative status is similar to proving a qualifying child. IRM 4.19.14.5.6, *Personal Exemptions and Dependents* (Jan. 01, 2015).

To calculate dollars protected, the EITC Return Preparer Strategy compares the change in potentially erroneous dollars of the control group to the treated group from one year to the next.[85] The change between the two groups is considered a benefit of the treatments.[86] The EITC Return Preparer Strategy measures the impact for each treatment type separately.[87] A TAS review of internal EITC Return Preparer Strategy reports indicates that each treatment type is tracked annually to show its return on investment and the bad dollars saved attributed to it.

One way in which the EITC Return Preparer Strategy could improve its analysis is to adopt a consistent approach to each year's work. For instance, since FY 2012, the EITC Return Preparer Strategy has introduced new key questions to be answered and objectives each year.[88] Such an approach does not allow for a year-to-year comparison. It also does not require the EITC Return Preparer Strategy to focus on one consistent goal. Instead, the EITC Return Preparer Strategy should adopt a core set of questions and objectives that guide the process and introduce new topics as they are identified.

As described above, not all individual preparers are tracked each year. Some may not prepare 25 returns after receiving a treatment and as a result, they will not return to the test sample.[89] We believe the EITC Return Preparer Strategy should create a core set of preparers who are tracked over time and introduce new preparers as they are identified.

Last, the current measurements for success, which include dollars protected and the return on investment, may not be the best measure to capture an increase in preparer compliance. In particular, the basis for the calculation may not be accurate as not all returns deemed "potentially erroneous" are actually erroneous, or are only partially in error. Once this calculation is improved, it will make the return on investment measurement more accurate. An improved return on investment measurement in addition to long-term tracking of a core group of preparers will show a more accurate picture of preparer compliance and the impact of IRS "touches" on that compliance.

Thus far, the IRS has shared only basic information about the EITC Return Preparer Strategy with the public. Given the importance of the EITC and the large number of preparers contributing to EITC noncompliance, transparency is extremely important. The ERCPC unit should release the annual analysis for the EITC Return Preparer Strategy to the public, including the measures used to evaluate the effectiveness of the strategy.

The EITC Return Preparer Strategy Does Not Sufficiently Focus on the Unenrolled Preparer Populations, Which Combined With a Comprehensive Public Education Campaign, Is Critical to Improving EITC Noncompliance

The low income population is particularly vulnerable to unskilled and unethical preparers and as numerous studies have shown, these preparers operate in the areas and communities where low income persons

85 IRS response to TAS information request (Oct. 21, 2015).

86 *Id*. As an example, the Strategy calculated that the average preparer receiving a treatment improved $15,000 after treatment, whereas the average preparer in the control group improved by $5,000. So the impact of treatments is estimated to be $10,000 on average. The total impact of treatments is then calculated by multiplying the average savings by the number of preparers in the test group. *Id.*

87 *Id*.

88 WIRA, *Fiscal Year 2015 EITC Return Preparer Analysis Summary* 3 (June 15, 2015).

89 Derived from IRS response to TAS information request (June 24, 2015). The IRS reports that it will continue to monitor every preparer after they are initially identified. However, TAS is unable to ascertain what this monitoring entails.

reside.[90] The ERCPC data show that compared to attorneys and Certified Public Accountants (CPA), unenrolled preparers receive the vast majority of compliance treatments. Between FYs 2012 and 2015, an average of 94 percent of all due diligence audits were performed on unenrolled preparers while four percent of the due diligence audits were conducted on enrolled agents, 1.6 percent on CPAs, and less than one percent were performed on attorneys, as shown on Figure 1.24.5.[91] The IRS should determine if due diligence audits are the most effective way to address unenrolled preparers. Based on current analysis, the Strategy measures its effectiveness of each treatment on return on investment and dollars saved. As mentioned above, these measurements may be flawed. Given the unique characteristics of the unenrolled population, the Strategy should ensure that the due diligence audit is more effective than the less costly knock and talk visit.

FIGURE 1.24.5, Due Diligence Audits by Preparer Enrollment, FYs 2012–2015[92]

Fiscal Year	CPA	Attorney	Enrolled Agent	Unenrolled
2012	1.3%	0.0%	2.4%	96.3%
2013	2.2%	0.1%	5.7%	92.0%
2014	1.3%	0.0%	2.7%	96.0%
2015	1.8%	0.1%	4.8%	93.3%
Average	**1.7%**	**0.05%**	**3.9%**	**94.4%**

The EITC Return Preparer Strategy does not have a way to identify if a preparer is unenrolled and instead relies on the preparer to self-identify during EITC due diligence audits.[93] Since the EITC Return Preparer Strategy already coordinates with the RPO and RPO attends the Strategy meetings, RPO could share preparer types and geographical location with the Strategy, if the preparer is in the RPO database.[94] If the preparer is not in the RPO database, then by definition that preparer is an unenrolled preparer or not in compliance with the requirement to obtain a preparer tax identification number (PTIN).[95] Currently the Strategy receives complaints about preparers from RPO but only treats 37 percent of these referrals because "most of the referral complaints are for preparers who file less than 25 EITC returns, are for issues that cannot be addressed with our current compliance tools, or are sole complaints from a single taxpayer concerning his/her preparer."[96] If the Strategy is not going to incorporate all of these referrals into its treatment cycle, it could at least glean information about the unenrolled population from the referrals.

Since the EITC Return Preparer Strategy cannot identify unenrolled preparers on its own, it offers information on due diligence requirements in the form of presentations and webinars and on social media to enrolled and unenrolled agents alike.[97] Sharing educational information is a good start, however,

90 For a chilling inventory of studies showing the predatory practices and abuses in this area, see Brief of Amici Curiae, National Consumer Law Center and National Community Tax Coalition in Support of Defendants-Appellants, *Loving v. Internal Revenue Service*, No. 13-5061 (D.C. Cir. 2014.)

91 IRS response to TAS information request (June 24, 2015).

92 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

93 IRS response to TAS information request (Oct. 21, 2015).

94 IRS response to TAS information request (June 24, 2015).

95 Unenrolled preparers may wish to "voluntarily increase their knowledge and improve their filing season competency." They can do this by taking 18 hours of continuing education, obtaining a PTIN, and agreeing to certain terms of Circular 230, *Regulations Governing Practice before the Internal Revenue Service*. IRS, *General Requirements*, *available at* https://www.irs.gov/Tax-Professionals/General-Requirements-for-the-Annual-Filing-Season-Program-Record-of-Completion.

96 IRS response to TAS information request (June 24, 2015).

97 *Id.*

a tailored approach that directly focuses on unscrupulous unenrolled preparers in the neighborhoods where they operate and where the potential victims reside, is essential to improving EITC compliance. For instance, when the RPO office shares individual complaints received from a single taxpayer with the EITC Return Preparer Strategy, these referrals do not become part of the treatment stream. However, the referrals could be investigated to learn more about where the unenrolled preparers concentrate their work. More compliance-driven educational material could be provided in these areas specifically to target unenrolled preparers. This material would focus on the consequences of disregarding due diligence requirements and filing bad returns, up to and including prosecution. This could be done by using preparer information provided in the referrals from RPO. The EITC Return Preparer Strategy could also partner with the LITC program and consumer rights groups to gain a better understanding of how these preparers operate.

In 2015, the IRS announced an online public directory of tax return preparers, which taxpayers can search to find a preparer with specific credentials or qualifications, including attorneys, CPAs, enrolled agents, and those who have taken the voluntary annual IRS filing season training.[98] Unenrolled preparers are not included in this database, but use of this directory should be advertised in the neighborhoods where unenrolled preparers practice to empower taxpayers to make educated decisions. Since 2002, TAS has recommended that taxpayer outreach be part of the EITC compliance strategy.[99] Presumably, many improper payments could have been saved if the IRS had followed through with this recommendation in 2002 to educate taxpayers. In 2002, TAS also proposed a legislative recommendation to allow Congressional authority and funding for "an extensive public awareness campaign" targeted at taxpayers.[100] The marketing campaign would include a simple message to inform taxpayers about the preparer registration process so that taxpayers could make educated decisions.

The marketing campaign could use internal information that the Strategy has based on referrals to target the message to certain geographic areas. The campaign should also utilize partners, such as LITCs, Volunteer Income Tax Assistance (VITA) programs, and local organizations providing services to the affected taxpayer populations.[101] The partners would help to develop the outreach as well as to deliver the information to a target audience. The information should include information on the due diligence requirements, so that taxpayers know what to expect when they visit a preparer. It should also include information on how to figure out if the preparer is reputable.

A public education component to the EITC Preparer Strategy would empower taxpayers to avoid some of the problematic preparers upfront. For instance, TAS created a poster and pamphlet in 2013 to educate taxpayers who rely on preparers.[102] By helping the taxpayer be an educated consumer, the public information campaign could reduce the amount of EITC noncompliance, while also decreasing costs associated with compliance treatments and resolving erroneous refunds.

98 IRS, IR-2015-22, *IRS Launches Directory of Federal Tax Return Preparers; Online Tool Offers New Option to Help Taxpayers*, *available at* http://www.irs.gov/uac/Newsroom/IRS-Launches-Directory-of-Federal-Tax-Return-Preparers (last visited Sept. 30, 2015).

99 National Taxpayer Advocate 2002 Annual Report to Congress 73.

100 *Id.* at 229.

101 For example, CA$H is a collaboration of ten state coalitions, made up of more than 50 non- and for-profit partners with the goal of helping low-to moderate income people "make the most of their money." For more information, see CA$H Maine, *About CA$H*, http://www.cashmaine.org/about (last visited Sept. 15, 2015).

102 TAS, Publication 5074, *Protect Your Tax Refund* (2013); TAS, Publication 5074-A, *Protect Your Tax Refund* (Mar. 2015). For more information on this educational material, *see* National Taxpayer Advocate 2013 Annual Report to Congress 70-71.

The EITC Preparer Strategy Does Not Collaborate With TAS

The Strategy benefits from many IRS partners and stakeholders. For instance, ERCPC is the owner and primary driver of the EITC Return Preparer Strategy, but collaborates with communication functions, research, and counsel.[103] TAS is listed as a stakeholder, however, the only time TAS was invited to participate in the EITC Return Preparer Strategy was a phone call in December 2013.

The IRS does not currently include TAS in planning for its EITC Return Preparer Strategy. However, the National Taxpayer Advocate has dedicated many resources to studying problems associated with the EITC and proposing solutions.[104] The National Taxpayer Advocate has also testified before Congress numerous times to highlight issues related to the EITC.[105] EITC cases consistently rank in the top ten of all TAS case receipts.[106] Last, the National Taxpayer Advocate also administers the LITC program, which provides legal representation in numerous EITC cases.[107] The LITCs see firsthand the problems taxpayers experience with preparers, often before the issues surface with the IRS. Given TAS's extensive knowledge, research, and affiliations, TAS should be involved in the IRS's EITC Return Preparer Strategy from the start, as well as to fine tune its focus and to develop quantifiable measures of strategy effectiveness.

CONCLUSION

The National Taxpayer Advocate commends ERCPC for its efforts to address the role that preparers play in EITC errors. However, the IRS is not effectively using the resources at its disposal, such as collaborating with TAS, other internal and external stakeholders and partners, and using referrals made about problematic preparers. Additionally, a creative and targeted outreach to unenrolled preparers and a comprehensive education campaign for taxpayers, including both localized campaigns targeted at areas where ghost or otherwise noncompliant preparers are operating, and nationwide public service advertisements, could augment the online public directory of tax return preparers. Success of the campaign would be measured not just by a reduction in bad returns and consideration of return on investment, but it would consider what types of errors are occurring by certain geographic areas. The strategy could focus efforts to study this over the longterm since sustained change in behavior for both preparers and taxpayers takes time.

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103 IRS response to TAS information request (June 24, 2015).

104 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 71-104 (*Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75-104 (*Running Social Programs Through the Tax System*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94-117 (*IRS Earned Income Credit Audits—A Challenge to Taxpayers*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-80 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

105 *See, e.g.*, *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 7 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *The National Taxpayer Advocate's 2014 Annual Report To Congress, Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28 (2015) (statement of Nina E. Olson, National Taxpayer Advocate).

106 A review of TAS case receipts since FY 2010 shows that EITC cases ranked ninth in 2010 (11,198 cases), tenth in FY 2011 (8,729 cases), seventh in FY 2012 (7,441 cases), fourth in FY 2013 (11,980 cases), third in FY 2014 (13,450 cases), and fourth in FY 2015 (10,880 cases). Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

107 LITCs represent individuals with limited income or low income. *Low Income Taxpayer Clinics Program Report* (Dec. 2014). In 2014, EITC cases were 12 percent of the LITC caseload. LITC Program 2014 Year End Report.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Release the annual analysis for the EITC Return Preparer Strategy to the public, including the measures used to evaluate the effectiveness of the strategy.
2. Include TAS as a member of the EITC Return Preparer Strategy team.
3. In collaboration with TAS and other IRS functions, and based on this annual analysis, determine where to focus resources and how to measure success with a multiyear analysis.
4. Incorporate preparer referrals, both from internal and external sources, and preparers who misuse PTINs, as a selection criterion for compliance treatment in the EITC Return Preparer Strategy.
5. Use measures for evaluating the effectiveness of the strategy on an annual basis that are not limited to measuring protected dollars or return on investment, but also include a year-to-year analysis of the preparer's behavior following treatment.
6. Tailor outreach specifically to the unenrolled preparer population that addresses due diligence requirements and is presented where these preparers operate. This outreach should incorporate TV and radio as well as social media.
7. Conduct a creative, geographic-based public education campaign in conjunction with other internal and external stakeholders including public service advertisements, videos, and tweets in order to educate taxpayers on how to select a competent preparer, what the rules of due diligence require, and the consequences of using an unskilled or unscrupulous preparer, including identity theft. Different marketing approaches should be tested and studied to track EITC compliance over the years.

APPENDIX A, Letter 5025 Series

LETTER 5025, *You May Have Prepared Inaccurate EITC Returns With Questionable Qualifying Children and Self-Employment Income*

Department of the Treasury
Internal Revenue Service
Wage & Investment
NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:
10/28/2015
Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns with Questionable Qualifying Children and Self-Employment Income

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and your clients. The primary issues we identified on the tax year 2014 returns you prepared are:

- Qualifying children for the EITC who don't appear to meet the relationship, residency, age, and joint return requirements.
  - A permanently and totally disabled child is considered to meet the age requirement. A child is considered permanently and totally disabled for EITC if the child can't engage in any substantial gainful activity because of a physical or mental condition, and a doctor determined the condition has lasted or can be expected to last continuously for at least one year or can be expected to lead to death.
- Questionable income and expenses on Schedule C, *Profit or Loss from Business.*

EITC due diligence requirements for paid preparers:
As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:
- Know the tax laws.
- Inform clients of EITC eligibility requirements to determine if each client qualifies for the EITC.
- Interview clients every year as their circumstances may change and you must use current information when determining eligibility for, and the amount of, the EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax laws.
- Meet all four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.

Letter 5025 (Rev. 9-2015)
Catalog Number 59926H

LETTER 5025C, *You May Have Prepared Inaccurate EITC Returns With Self-Employment Income*

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns with Self-Employment Income

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer, and your clients. The primary issues we identified on the tax year 2014 returns you prepared are questionable income and expenses on Schedule C, *Profit or Loss from Business.*

EITC due diligence requirements for paid preparers:

As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.
  3. Question the client if any information appears to be incorrect, inconsistent, or incomplete and document your questions and the client's responses. Failure to adequately question the client and document the responses is the most common reason we assess penalties.
  4. Keep all required records, including copies of any documents you relied upon to determine eligibility for, or the amount of, EITC.

Letter 5025-C (Rev. 9-2015)
Catalog Number 59927S

LETTER 5025D, *You May Have Violated Tax Law by Preparing Inaccurate EITC Returns*

Department of the Treasury
Internal Revenue Service
NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:
10/28/2015
To contact us toll free:
1-855-379-0440

You May Have Violated Tax Law
By Preparing Inaccurate EITC Returns

Dear [xxxxx]:

Our review of the Tax Year 2013 Earned Income Tax Credit (EITC) returns you prepared indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and your clients**.** The primary issues we identified on your TY 2013 returns is a high percentage of EITC returns that claim qualifying children who may not be permanently or totally disabled.

A child is considered permanently and totally disabled if both of the following apply:

- The child can't engage in any substantial gainful activity because of a physical or mental condition
- A doctor determines the condition has lasted or can be expected to last continuously for at least a year or can lead to death

If You Prepare Inaccurate EITC Returns

Your client may face:

- An audit during which we will hold his or her refund until we can determine EITC eligibility. We can also conduct an audit after we issue the refund. If we determine that your client doesn't qualify for EITC, he or she must repay any overpayment, plus interest.
- A ban for 2 or 10 years from claiming the EITC, if we determine your client's EITC claim was due to reckless or intentional disregard of the EITC rules or fraud

You may face:

- **A $500 penalty** for each failure to comply with EITC due diligence requirements (Section 6695(g) of the Internal Revenue Code)

Letter 5025-D (Rev. 8-2014)
Catalog Number 64087J

LETTER 5025Q, *You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying Children*

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying Children

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you, as the paid preparer, and your clients.

The primary issues we identified are questionable qualifying children who may not meet the residency or relationship tests, and/or questionable qualifying children who may not be permanently and totally disabled.

- A child is a qualifying child if he or she meets the relationship, age, residency, and joint return tests.
- A permanently and totally disabled child is considered to meet the age requirement. A child is considered permanently and totally disabled for EITC if the child can't engage in any substantial gainful activity because of a physical or mental condition, and a doctor determined the condition has lasted or can be expected to last continuously for at least one year or can be expected to lead to death.

EITC due diligence requirements for paid preparers:

As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.

Letter 5025-Q (Rev. 9-2015)
Catalog Number 59928D

INTRODUCTION: Legislative Recommendations

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

The figure immediately following this Introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2014 Annual Reports.[1] The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion highlights legislative activity during the 114th Congress relating to the National Taxpayer Advocate's proposals.

Consolidated Appropriations Act, 2016 and Taxpayer Bill of Rights

Shortly before this report went to print, Congress enacted the Consolidated Appropriations Act, 2016.[2] Most significantly, section 401 of this law codified the provisions of the Taxpayer Bill of Rights (TBOR), which had been adopted administratively by the IRS last year based on the National Taxpayer Advocate's recommendation.[3] The National Taxpayer Advocate advocated for this codification in several of her prior Annual Reports to Congress,[4] and members of both the House and Senate introduced various TBOR bills earlier in the year. Specifically, section 401 of the Consolidated Appropriations Act, 2016 amends IRC § 7803(a) to add a new paragraph that states: "In discharging his duties, the Commissioner shall 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" and includes the ten TBOR rights. The National Taxpayer Advocate is pleased with this codification of TBOR and will work with the IRS to ensure that this statutory mandate is fulfilled.

Also of note, Congress appropriated $290,000,000 above the IRS's FY 2016 funding level to be used solely to achieve "measurable improvements in the customer service representative level of service rate, to improve the identification and prevention of refund fraud and identity theft, and to enhance cybersecurity to safeguard taxpayer data."[5] Congress attached certain conditions to this funding, including that these funds will not be made available until the Commissioner submits a spending plan

1 An electronic version of the figure is available on the TAS website at www.TaxpayerAdvocate.irs.gov/2015-Annual-Report. The figure lists all legislative recommendations the National Taxpayer Advocate has made since 2001 and identifies each section of the Internal Revenue Code affected by the recommendations.

2 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 (2015).

3 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015). *See also* TBOR, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

4 *See* National Taxpayer Advocate 2014 Annual Report to Congress 275 (Legislative Recommendation: *Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections*); National Taxpayer Advocate 2013 Annual Report to Congress 5 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); National Taxpayer Advocate's Report to Acting Commissioner Daniel Werfel, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), *available at* www.TaxpayerAdvocate.irs.gov/2013AnnualReport; National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2007 Annual Report to Congress 478-89 (Key Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*).

5 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E, § 113 (2015).

to the Committees on Appropriations of the House of Representatives and the Senate.[6] The National Taxpayer Advocate welcomes this increase in IRS funding and is hopeful that it will alleviate taxpayer burden in the allocated areas.[7]

Other Consolidated Appropriations Act, 2016 Provisions

Besides TBOR, the Consolidated Appropriations Act, 2016 also enacted several of the National Taxpayer Advocate's previous recommendations to Congress, including:[8]

- **Dual Address Change Notices and Special Consideration for Offers in Compromise for Victims of Payroll Tax Preparer Fraud.**[9] For the third consecutive year, Congress enacted legislation that incorporates two of the National Taxpayer Advocate's past recommendations. Section 106 of the Consolidated Appropriations Act, 2016 requires the IRS to:
  1. Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address); and
  2. Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.[10] This provision codifies National Taxpayer Advocate recommendations from 2012.
- **Modification of filing dates of returns and statements relating to employee wage information and nonemployee compensation to improve compliance.**[11] The provision requires Forms W-2 and W-3 and returns or statements that report non-employee compensation (*e.g.*, Form 1099-MISC) to be filed on or before January 31 of the year following the calendar year to which the returns relate. The provision also provides additional time for the IRS to review refund claims based on the earned income tax credit and the refundable portion of the child tax credit in order to reduce fraud and improper payments. The provision is effective for returns and statements relating

6 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E, § 113 (2015).

7 The Consolidated Appropriations Act, 2016 legislation also increased funding for Volunteer Income Tax Assistance (VITA), allocating not less than $15,000,000 for VITA matching grants. *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E (2015). This is a $3,000,000 increase over last year's VITA funding, where Congress allocated not less than $12,000,000 for VITA matching grants. See Consolidated And Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, 128 STAT. 2130, 2336 (2014). In her 2014 Annual Report to Congress, the National Taxpayer Advocate recommended that the IRS increase VITA funding to maximize the overall resources (federal and matching funds) available for free tax preparation assistance. *See* National Taxpayer Advocate 2014 Annual Report to Congress 66 (Most Serious Problem: *VITA/TCE Funding: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*).

8 Relevant portions of the summaries of these new provisions are drawn from House Committee on Ways and Means, Section-By-Section Summary of the Proposed "Protecting Americans From Tax Hikes Act of 2015," *available at* http://waysandmeans.house.gov/?attachment_id=39841003.

9 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E, § 106 (2015).

10 *See* National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

11 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 201 (2015).

to calendar years after the date of enactment (*e.g.*, returns filed in 2017). This provision codifies a National Taxpayer Advocate recommendation from 2013 and prior Annual Reports.[12]

- **Safe harbor for *de minimis* errors on information returns and payee statements.**[13] The provision establishes a safe harbor from penalties for the failure to file correct information returns and for failure to furnish correct payee statements by providing that if the error is $100 or less ($25 or less in the case of errors involving tax withholding), the issuer of the information return is not required to file a corrected return and no penalty is imposed. A recipient of such a return (*e.g.*, an employee who receives a Form W-2) can elect to have a corrected return issued to him and filed with the IRS. The provision is effective for returns and statements required to be filed after December 31, 2016. This provision codifies a National Taxpayer Advocate recommendation from 2013.[14]
- **Requirements for the issuance of ITINs.**[15] The provision provides that the IRS may issue individual taxpayer identification numbers (ITINs) if the applicant provides the documentation required by the IRS either (a) in person to an IRS employee or to a community-based certified acceptance agent (as authorized by the IRS) or (b) by mail. This provision codifies a National Taxpayer Advocate administrative recommendation from 2008.[16] The provision also provides that an ITIN will expire if an individual fails to file a tax return for three consecutive years. This provision codifies a National Taxpayer Advocate administrative recommendation from 2010.[17]
- **Treatment of credits for purposes of certain penalties.**[18] Among other things, the provision, which generally applies to returns filed after December 31, 2015, provides reasonable cause relief from the 20 percent penalty under IRC § 6676 for erroneous claims for refunds or credits. This provision codifies National Taxpayer Advocate recommendations from last year and 2011.[19]

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12 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 69, 89, 91, 96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). Recommendation 2.2 of this study was to eliminate the March 31st deadline for e-filed information reports. All information reports, whether e-filed or filed on paper, would be due at the end of February; 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*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*); National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the 'Pay Refunds First, Verify Eligibility Later' Approach to Tax Return Processing*).

13 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 202 (2015).

14 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 69, 89, 91, 96 (Research Study: Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and *Decrease Improper Payments*). Recommendation 2.3 in this study was to minimize corrections by creating a $50 *de minimis* threshold for corrections.

15 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 203 (2015).

16 See National Taxpayer Advocate 2008 Annual Report to Congress 126-140 (Most Serious Problem: *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*). This discussion provided several administrative recommendations to the IRS to streamline the ITIN application process, including a recommendation to promote and expand the Certified Acceptance Agent program.

17 See National Taxpayer Advocate 2010 Annual Report to Congress 319-338 (Most Serious Problem: *Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers*). Among the administrative recommendations to the IRS in this discussion was a recommendation that the IRS develop a process to verify that previously issued ITINs have been used for tax administration purposes and revoke unused ITINs on a regular basis after notifying ITIN holders.

18 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 209 (2015).

19 See National Taxpayer Advocate 2014 Annual Report to Congress 351 (Legislative Recommendation: *Erroneous Refund Penalty: Amend Section 6676 to Permit "Reasonable Cause" Relief*); National Taxpayer Advocate 2011 Annual Report to Congress 544 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*).

- **Declaratory judgments for IRC § 501(c)(4) and other exempt organizations.**[20] The provision permits 501(c)(4) organizations and other exempt organizations to seek review in Federal court of any revocation of exempt status by the IRS. The provision applies to pleadings filed after the date of enactment. This provision codifies a National Taxpayer Advocate recommendation from last year.[21]

- **Suspension of running of period for filing petition of spousal relief and collection cases.**[22] The provision suspends the statute of limitations in cases involving spousal relief or collections when a bankruptcy petition has been filed and a taxpayer is prohibited from filing a petition for review by the Tax Court. Under the provision, the suspension is for the period during which the taxpayer is prohibited from filing such a petition, plus 60 days. The provision applies to Tax Court petitions filed after the date of enactment. This provision codifies National Taxpayer Advocate recommendations from 2004 and 2006.[23]

The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015

On July 31, 2015, Congress enacted the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015.[24] The Act will, beginning in 2016, change the return filing due date for partnerships and certain trusts from the 15th day of the fourth month following the close of the tax year to the 15th day of the third month following the close of the tax year.[25] This change codifies a National Taxpayer Advocate recommendation from 2003.[26] In addition, beginning in 2016, this legislation moves up the due date, from June 30 to April 15, for taxpayers with a financial interest in or signature authority over certain foreign financial accounts to file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*.[27] The new legislation also provides for a maximum six month extension (*i.e.*, until October 15) to file this form.[28] This change codifies a National Taxpayer Advocate recommendation from last year.[29]

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20 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 406 (2015).

21 *See* National Taxpayer Advocate 2014 Annual Report to Congress 371 (Legislative Recommendation: *EO Judicial And Administrative Review: Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status*). The provision goes beyond the National Taxpayer Advocate's recommendation as it is does not limit declaratory judgment rights under IRC § 7428 to organizations exempt under IRC §§ 501(c)(4), (c)(5), and (c)(6).

22 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 424 (2015).

23 *See* National Taxpayer Advocate 2006 Annual Report to Congress 536-7 (Additional Legislative Recommendation: *Suspend the Period for Filing a Tax Court Petition During Bankruptcy*); National Taxpayer Advocate 2004 Annual Report to Congress 490-1 (Additional Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

24 *See* Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, 129 Stat. 443 (2015).

25 *See* Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, § 2006, 129 Stat. 443, 457 (2015).

26 *See* National Taxpayer Advocate 2003 Annual Report to Congress 302 (Key Legislative Recommendation: *Filing Due Date of Partnership and Certain Trusts*).

27 *See* Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, § 2006, 129 Stat. 443, 458-59 (2015).

28 *Id*. at 459

29 *See* National Taxpayer Advocate 2014 Annual Report to Congress 331 (Legislative Recommendation: *Foreign Account Reporting: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure*). As the title indicates, this legislative recommendation contained several proposals, one of which was to change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938, *Statement of Specified Foreign Financial Assets* (including extensions).

The following sections discuss bills introduced during the 114th Congress that reflect legislative recommendations made by the National Taxpayer Advocate in her prior Annual Reports to Congress.

Taxpayer Rights Act of 2015

On November 30, 2015, Senator Cardin and Representative Becerra introduced companion bills entitled the Taxpayer Rights Act of 2015 (TRA 2015).[30] The legislation would codify the TBOR and require the Commissioner of Internal Revenue to develop annual training for all Internal Revenue Service officers and employees regarding taxpayer rights, the Office of the Taxpayer Advocate's case criteria and mission, and Taxpayer Assistance Order procedures.[31] As noted above, Congress codified the TBOR in the Consolidated Appropriations Act, 2016.[32]

TRA 2015 contains many of the National Taxpayer Advocate's prior proposals. The legislation would establish a Community Volunteer Income Tax Assistance Matching Grant Program (VITA grant program).[33] The VITA grant program would be administered in a manner that is substantially similar to the Community Volunteer Income Tax Assistance matching grants demonstration program established under Title I of Division D of the Consolidated Appropriations Act, 2008. The VITA grant program would establish tax preparation sites for low income taxpayers and operate in a manner similar to the Low Income Taxpayer Clinics (LITC) program.[34] In addition, the legislation would authorize the Secretary to promote the benefits of and encourage the use of qualified LITCs through the use of mass communications, referrals, and other means and allow IRS employees to refer taxpayers to the LITCs.[35]

The National Taxpayer Advocate has recommended that the IRS create an effective oversight and penalty regime for return preparers;[36] TRA 2015 would require the IRS to regulate any preparers not already regulated, create a penalty for unauthorized preparation of returns, and expand and increase current preparer penalties.[37] The legislation also includes registration and disclosure requirements and new penalties for persons facilitating refund delivery products.[38]

The National Taxpayer Advocate has advocated for numerous changes to the IRS's filing and reporting of federal tax liens.[39] Under TRA 2015, the IRS would have to weigh the benefit to the government and the harm to the taxpayer before filing a lien and would have to provide the taxpayer with an opportunity to

30 Taxpayer Rights Act of 2015, S. 2333, 114th Cong. (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. (2015).

31 S. 2333, § 308, 114th Cong. (2015); H.R. 4128, § 308, 114th Cong. (2015).

32 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015).

33 S. 2333, § 201, 114th Cong. (2015); H.R. 4128, § 201, 114th Cong. (2015).

34 *See* National Taxpayer Advocate 2014 Annual Report to Congress 55-66 (Most Serious Problem: *VITA/TCE Funding: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*).

35 *See* National Taxpayer Advocate 2014 Annual Report to Congress 411-416 (Legislative Recommendation: *Contact Information On Statutory Notices Of Deficiency: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population*); National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*); National Taxpayer Advocate 2007 Annual Report to Congress 551–553 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

36 *See, e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*), National Taxpayer Advocate 2008 Annual Report to Congress 423-26 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*).

37 S. 2333, §§ 202 and 203, 114th Cong. (2015); H.R. 4128, §§ 202 and 203, 114th Cong. (2015). The bill increases the preparer penalty for gross misconduct to 100 percent of the amount of the understatement of tax. *Id*.

38 S. 2333, §§ 202 and 203, 114th Cong. (2015); H.R. 4128, §§ 202 and 203, 114th Cong. (2015).

39 *See, e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 357-64 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*).

appeal the lien determination before the lien is filed.[40] Additionally, the bill would amend the Fair Credit Reporting Act to require removal of derogatory lien-filing information from credit reports under certain circumstances.[41]

TRA 2015 also includes the National Taxpayer Advocate's 2011 recommendation to clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.[42] In addition, the legislation would require the IRS to have at least one Appeals officer and one settlement officer assigned to each State and made available to the residents of each such State.[43] Further, the legislation would allow the National Taxpayer Advocate to appeal to the Commissioner for final determination a decision by the IRS Deputy Commissioner to modify or rescind of a Taxpayer Assistance Order.[44] Finally, the legislation would codify the National Taxpayer Advocate's authority to issue a Taxpayer Advocate Directive to the IRS.[45]

Taxpayer Bill of Rights Enhancement Act of 2015

On June 16, 2015, Senators Grassley and Thune introduced the Taxpayer Bill of Rights Enhancement Act of 2015, which would amend IRC § 7803 to require the Commissioner of Internal Revenue to ensure that IRS employees are familiar with and act in accordance with taxpayer rights.[46] As noted above, this provision was enacted in the Consolidated Appropriations Act, 2016.[47] The proposed legislation would also:

- Hold individuals harmless on improper levy on individual retirement plans.[48]
- Provide authority to the National Taxpayer Advocate to comment on Treasury Regulations.[49]

40 S. 2333, § 301, 114th Cong. (2015) and H.R. 4128, § 301, 114th Cong. (2015).

41 S. 2333, § 302, 114th Cong. (2015) and H.R. 4128, § 302, 114th Cong. (2015).

42 S. 2333, § 303, 114th Cong. (2015) and H.R. 4128, § 303, 114th Cong. (2015). *See* National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) Is De Novo*).

43 S. 2333, § 309, 114th Cong. (2015); H.R. 4128, § 309, 114th Cong. (2015). *See* National Taxpayer Advocate 2014 Annual Report to Congress 311 (Legislative Recommendation: *Access to Appeals: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico*); National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*).

44 S. 2333, § 401, 114th Cong. (2015) and H.R. 4128, § 401, 114th Cong. (2015).

45 S. 2333, § 402, 114th Cong. (2015) and H.R. 4128, § 402, 114th Cong. (2015). *See* National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*). Taxpayer Advocate Directives mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers or all taxpayers. IRM 13.1.4.2.2.5, *Delegation Order No. 250 — Authority to Issue Taxpayer Advocate Directives* (Oct. 31, 2004).

46 S. 1578, § 101, 114th Cong. (2015).

47 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015).

48 S. 1578, § 402, 114th Cong. (2015). *See* National Taxpayer Advocate 2001 Annual Report to Congress 202–214 (Legislative Recommendation: *Reinstatement of Retirement Account*).

49 S. 1578, § 404, 114th Cong. (2015). *See* National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*).

- Require the IRS to have at least one Appeals officer and one settlement officer located and permanently available in each State, the District of Columbia, and Puerto Rico.[50]

Small Business Taxpayer Bill of Rights Act of 2015

On April 15, 2015, Senator Cornyn and Representative Thornberry introduced the Small Business Taxpayer Bill of Rights Act of 2015, which would enact a number of the National Taxpayer Advocate's previous recommendations.[51] The legislation would prohibit *ex parte* communications between Appeals officers and other IRS employees.[52] The bill also includes two recommendations relating to collection. First, it would extend the period in which a third party can bring a suit for return of levied funds or proceeds.[53] Second, it would waive the installment agreement fee for taxpayers whose adjusted gross income does not exceed 250 percent of the federal poverty level.[54]

Finally, the legislation contains two of the National Taxpayer Advocate's recommendations regarding relief from joint and several liability. The bill would suspend the running of the period for filing a Tax Court petition seeking review of an innocent spouse claim or collection due process determination for the period of time the taxpayer is prohibited because of the automatic stay imposed under section 362 of the Bankruptcy Code from filing the petition, plus 60 additional days.[55] The legislation would also clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.[56]

Taxpayer Bill of Rights Act of 2015

On February 25, 2015, Representative Roskam introduced the Taxpayer Bill of Rights Act of 2015, which would amend IRC § 7803 to require the Commissioner of Internal Revenue to ensure that IRS employees are familiar with and act in accordance with taxpayer rights.[57] As noted above, this provision was enacted

50 S. 1578, § 602, 114th Cong. (2015). *See* National Taxpayer Advocate 2014 Annual Report to Congress 311 (Legislative Recommendation: *Access to Appeals: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico*); National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*).

51 Small Business Taxpayer Bill of Rights Act of 2015, S. 949, 114th Cong. (2015); H.R. 1828, 114th Cong. (2015).

52 S. 949, § 7, 114th Cong. (2015); H.R. 1828, § 7, 114th Cong. (2015). *See* National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*) (noting the IRS Restructuring and Reform Act of 1998 prohibits *ex parte* communication between Appeals employees and other IRS employees, but recent IRS practices allowing Appeals employees to share office space with other IRS employees foster a perception of a lack of independence).

53 S. 949, § 9, 114th Cong. (2015); H.R. 1828, § 9, 114th Cong. (2015). The bill extends the time for third parties to bring suit from nine months to three years. *See* National Taxpayer Advocate 2001 Annual Report to Congress 202-09 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

54 S. 949, § 10, 114th Cong. (2015); H.R. 1828, § 10, 114th Cong. (2015). *See* National Taxpayer Advocate 2006 Annual Report to Congress 141-56 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*) (recommending the IRS implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required).

55 S. 949, § 11, 114th Cong. (2015); H.R. 1828, § 11, 114th Cong. (2015). *See* National Taxpayer Advocate 2006 Annual Report to Congress 536-7 (Additional Legislative Recommendation: *Suspend the Period for Filing a Tax Court Petition During Bankruptcy*); National Taxpayer Advocate 2004 Annual Report to Congress 490-92 (Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

56 S. 949, § 14, 114th Cong. (2015); H.R. 1828, § 14, 114th Cong. (2015). *See* National Taxpayer Advocate 2006 Annual Report to Congress 536-7 (Additional Legislative Recommendation: *Suspend the Period for Filing a Tax Court Petition During Bankruptcy*); National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*).

57 Taxpayer Bill of Rights Act of 2015, H.R. 1058, 114th Cong. (2015).

in the Consolidated Appropriations Act, 2016.[58] On April 15, 2015, the bill was approved by the House of Representatives, but the Senate did not act on it.

Consolidate Education Incentives

The National Taxpayer Advocate has recommended consolidating and simplifying various Code provisions to make compliance less difficult.[59] In March 2015, Senator Schumer and Representative Doggett introduced companion bills that include the National Taxpayer Advocate's recommendation to consolidate the education tax credits known as the Hope Scholarship and the Lifetime Learning Credits.[60] The proposed legislation would amend the Code to replace the two credits with a new American Opportunity Tax Credit that: (1) allows an income tax credit of up to $3,000 of the qualified tuition and related expenses of a student who is carrying at least one half of a normal course load; (2) increases the income threshold for reductions in the credit amount based on modified adjusted gross income; (3) allows a lifetime dollar limitation on such credit of $15,000 for all taxable years; and (4) makes 40 percent of the credit refundable. Additionally, the bill allows an exclusion from gross income of any amount received as a federal Pell grant.

58 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015).

59 *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 370-72 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*).

60 S. 699, 114th Cong. (2015); H.R. 1260, 114th Cong. (2015).

National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82–100; National Taxpayer Advocate 2004 Annual Report to Congress 383–385; National Taxpayer Advocate 2008 Annual Report to Congress 356–362.	Repeal the AMT outright.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 1616	Lee	10/30/2013	Referred to the Finance Committee
	HR 243	Ross	1/14/2013	Referred to Ways & Means Committee
Legislative Activity 112th Congress	HR 86	Bachmann	1/5/2011	Referred to Ways & Means Committee
	HR 99	Dreler	1/5/2011	Referred to Ways & Means Committee
	HR 547	Garrett	2/8/2011	Referred to Ways & Means Committee
	HR 3400	Garrett	11/10/2011	Referred to Ways & Means Committee
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 820	Shelby	4/14/2011	Referred to the Finance Committee
	HR 3804	Huelskamp	1/23/2012	Referred to Ways & Means Committee
Legislative Activity 111th Congress	S 3018	Wyden	2/23/2010	Referred to the Finance Committee
	HR 240	Garrett	1/7/2009	Referred to the Ways & Means Committee
	HR 782	Paul	1/28/2009	Referred to the Ways & Means Committee
	S 932	Shelby	4/30/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	S 55	Baucus	1/4/2007	Referred to the Finance Committee
	S 14	Kyl	4/17/2007	Referred to the Finance Committee
	S 1040	Shelby	3/29/2007	Referred to the Finance Committee
	HR 1366	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
	S 2293	Lott	11/1/2007	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464
Legislative Activity 109th Congress	HR 1186	English	3/9/2005	Referred to the Ways & Means Committee
	S 1103	Baucus	5/23/2005	Referred to the Finance Committee
	HR 2950	Neal	6/16/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee

Legislative Activity 108th Congress	HR 43	Collins	1/7/2003	Referred to the Ways & Means Committee
	HR 1233	English	3/12/2003	Referred to the Ways & Means Committee
	S 1040	Shelby	5/12/2003	Referred to the Finance Committee
	HR 3060	N. Smith	9/10/2003	Referred to the Ways & Means Committee
	HR 4131	Houghton	4/2/2004	Referred to the Ways & Means Committee
	HR 4164	Shuster	4/2/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 437	English	2/6/2001	Referred to the Ways & Means Committee
	S 616	Hutchison	3/26/2002	Referred to the Finance Committee
	HR 5166	Portman	7/18/2002	Referred to the Ways & Means Committee
Index AMT for Inflation National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	If full repeal of the individual AMT is not possible, it should be indexed for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3223	McConnell	9/13/2010	Placed on the Senate Calendar
	HR 5077	Hall	4/20/2010	Referred to the Ways & Means Committee
	HR 719	Lee	1/27/2009	Referred to the Ways & Means Committee
	S 722	Baucus	3/26/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	HR 703	Garrett	2/9/2005	Referred to the Ways & Means Committee
	HR 4096	Reynolds	10/20/2005	12/7/2005–Passed the House; 12/13/2005–Placed on the Senate Legislative Calendar
Legislative Activity 108th Congress	HR 22	Houghton	1/7/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/1/2002	Referred to the Ways & Means Committee
Eliminate Several Adjustments for Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 336	DeMint	2/14/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 102	Kerry	1/4/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1861	Harkin	10/7/2005	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 1939	Neal	5/12/2003	Referred to the Ways & Means Committee

Private Debt Collection (PDC)				
Repeal PDC Provisions National Taxpayer Advocate 2006 Annual Report to Congress 458–462.	Repeal IRC § 6306, thereby terminating the PDC initiative.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 796	Lewis	2/3/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	S 335	Dorgan	1/18/2007	Referred to the Finance Committee
	HR 695	Van Hollen	1/24/2007	Referred to the Ways & Means Committee
	HR 3056	Rangel	7/17/2007	10/10/2007-Passed the House; 10/15/2007 Referred to the Finance Committee

Tax Preparation and Low Income Taxpayer Clinics (LITC)				
Matching Grants Program for Return Preparation National Taxpayer Advocate 2002 Annual Report to Congress vii–viii.	Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.			
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division E (2015).**			
	Bill Number	Sponsor	Date	Status
	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 113th Congress	**Pub. L. No. 113-235, Division E, 128 STAT. 2130, 2336 (2014).**			
Legislative Activity 111th Congress	**Pub. L. No. 111-117, Div. C, Title I, 123 Stat. 3034, 3163 (2009).**			
Legislative Activity 110th Congress	**Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).**			
	Bill Number	Sponsor	Date	Status
	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
	S 1967	Clinton	8/2/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	S 476	Grassley	2/27/2003	Referred to the Finance Committee
	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2001	Referred to the Ways & Means Committee
	HR 7	Baucus	7/16/2002	Reported by Chairman Baucus with an amendment; referred to the Finance Committee
Referrals to LITCs National Taxpayer Advocate 2007 Annual Report to Congress 551–553.	Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 1573	Durbin	9/15/2011	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 171
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Regulation of Income Tax Return Preparers National Taxpayer Advocate 2002 Annual Report to Congress 216–230; National Taxpayer Advocate 2003 Annual Report to Congress 270–301; National Taxpayer Advocate 2007 Annual Report to Congress 83–95 & 140-155; National Taxpayer Advocate 2008 Annual Report to Congress 423–426; National Taxpayer Advocate 2009 Annual Report to Congress 41–69. National Taxpayer Advocate 2009 Annual Report to Congress 60-74	Create an effective oversight and penalty regime for return preparers by taking the following steps: ◆ Enact a registration, examination, certification, and enforcement program for federal tax return preparers; ◆ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight; ◆ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and ◆ Require the IRS to take steps within its existing administrative authority, including requiring a checkbox on all returns in which preparers would enter their category of return preparer (*i.e.*, attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee

Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Identity Theft Single Point of Contact National Taxpayer Advocates 2013 Annual Report	Designate a single point of contact for identity theft victims to work with the identity theft victim until all related issues are resolved.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 2736	Hatch	7/31/2014	Referred to Finance Committee
Public Awareness Campaign for Low Income Taxpayer Clinics National Taxpayer Advocate 2014 Annual Report to Congress 411-416; National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 1-26; National Taxpayer Advocate 2007 Annual Report to Congress 551 -553.	Authorize the Secretary to promote the benefits of and encourage the use of qualified LITCs through the use of mass communications, referrals, and other means.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Public Awareness Campaign on Registration Requirements National Taxpayer Advocate 2002 Annual Report to Congress 216–230.	Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee

Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Increase Preparer Penalties National Taxpayer Advocate 2003 Annual Report to Congress 270–301.	Strengthen oversight of all preparers by enhancing due diligence and signature requirements, increasing the dollar amount of preparer penalties, and assessing and collecting those penalties, as appropriate.			
Legislative Activity 112th Congress	**Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011).**			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 4318	Crowley/ Ramstad	12/6/2007	Referred to the Ways & Means Committee
	S 2851	Bunning	4/14/2008	Referred to the Finance Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

Refund Delivery Options National Taxpayer Advocate 2008 Report to Congress 427–441.	Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Senate Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
Small Business Issues				
Health Insurance Deduction/Self-Employed Individuals National Taxpayer Advocate 2001 Annual Report to Congress 223; National Taxpayer Advocate 2008 Annual Report to Congress 388–389.	Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.			
Legislative Activity 111th Congress	**Pub. L. No. 111-240, § 2504 STAT 2560 (2010).**			
	Bill Number	Sponsor	Date	Status
	S 725	Bingaman	3/26/2009	Referred to the Finance Committee
	HR 1470	Kind	3/12/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	S 2239	Bingaman	10/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 663	Bingaman	3/17/2005	Referred to the Finance Committee
	S 3857	Smith	9/16/2006	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 741	Sanchez	2/12/2003	Referred to the Ways & Means Committee
	HR 1873	Manzullo Velazquez	4/30/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	S 2130	Bingaman	4/15/2002	Referred to the Finance Committee
Married Couples as Business Co-owners National Taxpayer Advocate 2002 Annual Report to Congress 172–184.	Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of subchapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.			
Legislative Activity 110th Congress	**Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).**			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee

Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, with an amendment
	S 842	Kerry	4/9/2003	Referred to the Finance Committee
	HR 1640	Udall	4/3/2003	Referred to the Ways & Means Committee
	HR 1558	Doggett	4/2/2003	Referred to the Ways & Means Committee
Income Averaging for Commercial Fishermen National Taxpayer Advocate 2001 Annual Report to Congress 226.	Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).**			
Election to be Treated as an S Corporation National Taxpayer Advocate 2004 Annual Report to Congress 390–393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, *U.S. Income Tax Return for an S Corporation.*			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 2271	Franken	3/29/2012	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Regulation of Payroll Tax Deposits Agents National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	◆ Amend the Code to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees; ◆ Amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause; and ◆ Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.			
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division E, § 106 (2015).**			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 900	Mikulski	05/08/2013	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614

Issue Dual Address Change Notice National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address)			
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division E, § 106 (2015).**			
Legislative Activity 113th Congress	**Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).**			
Special Consideration for offer in compromise National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.			
Legislative Activity 113th Congress	**Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).**			
Simplification				
Reduce the Number of Tax Preferences National Taxpayer Advocate 2010 Annual Report to Congress 365–372.	Simplify the complexity of the tax code generally by reducing the number of tax preferences.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
Simplify and Streamline Education Tax Incentives National Taxpayer Advocate 2008 Annual Report to Congress 370–372; National Taxpayer Advocate 2004 Annual Report to Congress 403–422.	Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221, (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer, (3) the definitions for "Qualified Higher Education Expenses" and "Eligible Education Institution" should be simplified, (4) the income level and phase-out calculations should be more consistent under the various provisions, (5) all dollar amounts should be indexed for inflation, and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 699	Schumer	3/10/2015	Referred to the Finance Committee
	HR 1260	Doggett	3/4/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 835	Schumer	4/25/2013	Referred to the Finance Committee
	HR 1738	Doggett	4/25/2013	Referred to the Ways & Means Committee
	HR 3476	Israel	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 3267	Schumer	6/6/2012	Referred to the Finance Committee
	HR 6522	Israel	9/21/2012	Referred to the Ways & Means Committee

Simplify and Streamline Retirement Savings Tax Incentives National Taxpayer Advocate 2008 Annual Report to Congress 373–374; National Taxpayer Advocate 2004 Annual Report to Congress 423–432.	Consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement plan for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
Tax Gap Provisions				
Corporate Information Reporting National Taxpayer Advocate 2008 Annual Report to Congress 388.	Require businesses that pay $600 or more during the year to non-corporate and corporate service providers to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 1796	Baucus	10/19/2009	10/19/2009 Placed on Senate Legislative Calendar under General Orders. Calendar No. 184
Reporting on Customer's Basis in Security Transaction National Taxpayer Advocate 2005 Annual Report to Congress 433–441.	Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B.			
Legislative Activity 110th Congress	**Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).**			
	Bill Number	Sponsor	Date	Status
	HR 878	Emanuel	2/7/2007	Referred to the Ways & Means Committee
	S 601	Bayh	2/14/2007	Referred to the Finance Committee
	S 1111	Wyden	4/16/2007	Referred to the Finance Committee
	HR 2147	Emanuel	5/3/2007	Referred to the Ways & Means Committee
	HR 3996 PCS	Rangel	10/30/2007	11/14/2007–Placed on the Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision
Legislative Activity 109th Congress	S 2414	Bayh	3/14/2006	Referred to the Finance Committee
	HR 5176	Emanual	4/25/2006	Referred to the Ways & Means Committee
	HR 5367	Emanual	5/11/2006	Referred to the Ways & Means Committee
IRS Forms Revisions National Taxpayer Advocate 2004 Annual Report to Congress 480; National Taxpayer Advocate 2010 Annual Report to Congress 40.	Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee

IRS to Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS) National Taxpayer Advocate 2005 Annual Report to Congress 381–396.	Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Study of Use of Voluntary Withholding Agreements National Taxpayer Advocate 2004 Annual Report to Congress 478–489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336. 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Require Form 1099 Reporting for Incorporated Service Providers National Taxpayer Advocate 2007 Annual Report to Congress 494–496.	Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.			
Legislative Activity 111th Congress	**Pub. L No. 111-148 § 9006 (2010).** However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over $600, but Require Reporting on Corporate and Certain Other Payments.			
Require Financial Institutions to Report All Accounts to the IRS by Eliminating the $10 Threshold on Interest Reporting National Taxpayer Advocate 2007 Annual Report to Congress 501–502.	Eliminate the $10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee

Revise Form 1040, Schedule C to Break Out Gross Receipts Reported on Payee Statements Such as Form 1099 National Taxpayer Advocate 2007 Annual Report to Congress 40.	Administrative recommendation that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099 National Taxpayer Advocate 2007 Annual Report to Congress 40.	Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: "Did you make any payments over $600 in the aggregate during the year to any unincorporated trade or business?" and "If yes, did you file all required Forms 1099?" S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Authorize Voluntary Withholding Upon Request National Taxpayer Advocate 2007 Annual Report to Congress 493–494.	Authorize voluntary withholding agreements between independent contractors and service recipients.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Require Backup Withholding on Certain Payments When TINs Cannot Be Validated National Taxpayer Advocate 2005 Annual Report to Congress 238–248.	Administrative recommendation that the IRS require payors to commence backup withholding if they do not receive verification of a payee's TIN. (S. 3795 would require voluntary withholding on certain payments.)			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Worker Classification National Taxpayer Advocate 2008 Annual Report to Congress 375–390.	Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee

Taxpayer Bill of Rights and *De Minimis* "Apology" Payments				
Taxpayer Bill of Rights National Taxpayer Advocate 2014 Annual Report to Congress National Taxpayer Advocate 2013 Annual Report to Congress National Taxpayer Advocate 2011 Annual Report to Congress 493-518 National Taxpayer Advocate 2007 Annual Report to Congress 478–48.	Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.			
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division Q § 401 (2015).**			
	Bill Number	Sponsor	Date	Status
	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 1578	Grassley	6/16/2015	Referred to the Finance Committee
	S 943	Portman	4/15/2015	Referred to the Finance Committee
	S 951	Ayotte	4/15/2015	Referred to the Finance Committee
	HR 1058	Roskam	2/25/2015	Passed the House of Representatives, and was referred to the Senate Finance Committee on 4/16/2015
Legislative Activity 113th Congress	HR 2768	Roskam	6/22/2013	Passed the House of Representatives, and was referred to the Senate Finance Committee on 8/31/2013
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
***De Minimis* "Apology" Payments** National Taxpayer Advocate 2007 Annual Report to Congress 490.	Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide *de minimis* compensation to taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the IRC § 7811 definition of significant hardship.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Simplify the Tax Treatment of Cancellation of Debt Income				
Simplify the Tax Treatment of Cancellation of Debt Income National Taxpayer Advocate 2008 Annual Report to Congress 391–396.	Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 4561	Lewis	2/2/2010	Referred to the Ways & Means Committee

Joint and Several Liability				
Tax Court Review of Request for Equitable Innocent Spouse Relief National Taxpayer Advocate 2001 Annual Report to Congress 128–165.	Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.			
Legislative Activity 109th Congress	**Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).**			
Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court). National Taxpayer Advocate 2004 Annual Report to Congress 490–92.	Allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Ways & Means Committee
Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is *De Novo*. National Taxpayer Advocate 2011 Annual Report to Congress 531–536.	Amend IRC § 6015 to specify that the scope and standard of review in tax court determinations under IRC § 6015(f) is *de novo*.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee

Collection Issues				
Improve Offer In Compromise Program Accessibility National Taxpayer Advocate 2006 Annual Report to Congress 507–519.	Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee
Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens 2009 National Taxpayer Advocate Report to Congress 357–364.	Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFTL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 6439	Hastings	11/18/2010	Referred to the Ways & Means Committee
Permit the IRS to Release Levies on Small Business Taxpayers 2011 National Taxpayer Advocate Report to Congress 537–543.	Amend IRC § 6343(a)(1)(d) to: permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4368	McDermott	4/17/2012	Referred to the Ways & Means Committee

Return of Levy or Sale Proceeds National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 1578	Grassley	6/16/2015	Referred to the Finance Committee
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House
	HR 586	Lewis	2/13/2001	4/18/02–Passed the House with an amendment; referred to the Senate

Reinstatement of Retirement Accounts National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343: ◆ § 401 – Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans ◆ § 408 – Individual Retirement Account, and SEP-Individual Retirement Account ◆ § 408A – Roth Individual Retirement Account			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 1578	Grassley	6/16/2015	Finance Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614

Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in H.R. 1528 through an amendment and HR 1528 passed in lieu of S 882
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Consolidation of Appeals of Collection Due Process (CDP) Determinations National Taxpayer Advocate 2005 Annual Report to Congress 451–470.	Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.			
Legislative Activity 109th Congress	**Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).**			
Partial Payment Installment Agreements National Taxpayer Advocate 2001 Annual Report to Congress 210–214.	Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the IRS.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 833, 118 Stat. 1418, 1600 (2004).**			
Waiver of Installment Agreement Fees for Low Income Taxpayers National Taxpayer Advocate 2006 Annual Report to Congress 141–56 (Most Serious Problem: Collection Issues of Low Income Taxpayers).	Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Strengthen the Independence of the IRS Office of Appeals National Taxpayer Advocate 2009 Annual Report to Congress 346-350.	Strengthen the independence of the IRS office of Appeals and require at least one appeals officer and settlement officer in each state. In addition the Office of Appeals should be independent from the IRS, should eliminate prohibited ex parte communications with the IRS.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 1578	Grassley	6/16/2015	Referred to the Finance Committee
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways & Means Committee

Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Penalties and Interest				
Erroneous Refund Penalty National Taxpayer Advocate 2014 Annual Report to Congress 351. National Taxpayer Advocate 2011 Annual Report to Congress 544.	Amend section 6676 to clarify that the penalty does not apply to individual taxpayers who acted with reasonable cause and in good faith in erroneously claiming a credit or refund. Taking into account all of taxpayers' facts and circumstances in determining whether they had such reasonable cause would bring this statutory penalty into conformity with the TBOR right to a fair and just tax system.			
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division Q § 209 (2015).**			
Interest Rate and Failure to Pay Penalty National Taxpayer Advocate 2001 Annual Report to Congress 179–182.	Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Interest Abatement on Erroneous Refunds National Taxpayer Advocate 2001 Annual Report to Congress 183–187.	Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 726	Sanchez	2/9/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
First Time Penalty Waiver National Taxpayer Advocate 2001 Annual Report to Congress 188–192.	Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in the House

Federal Tax Deposit (FTD) Avoidance Penalty National Taxpayer Advocate 2001 Annual Report to Congress 222.	Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Family Issues				
Uniform Definition of a Qualifying Child National Taxpayer Advocate 2001 Annual Report to Congress 78–100.	Create a uniform definition of "qualifying child" applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	**Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).**			
Means Tested Public Assistance Benefits National Taxpayer Advocate 2001 Annual Report to Congress 76–127.	Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or "not married" status.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/01/2002	Referred to the Ways & Means Committee
Credits for the Elderly or the Permanently Disabled National Taxpayer Advocate 2001 Annual Report to Congress 218–219.	Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 107th Congress	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee

Electronic Filing Issues				
Scanable Returns National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Require electronically prepared paper returns to include scanable 2-D code.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S. 2736	Hatch	7/14/14	Referred to the Finance Committee
Return Filing and Processing National Taxpayer Advocate 2013 Annual Report to Congress, Volume 2, 68-96.	Eliminate the March 31st deadline for e-filed information reports. All information reports, whether e-filed or filed on paper, would be due at the end of February.			
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division Q § 201 (2015).**			
Safe harbor for *de minimis* errors returns and payee statements National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Safe harbor for *de minimis* errors on information			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division Q § 202 (2015).**			
Legislative Activity 113th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee
Direct Filing Portal National Taxpayer Advocate 2004 Annual Report to Congress 471–477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Free Electronic Filing For All Taxpayers National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee

Office of the Taxpayer Advocate				
Confidentiality of Taxpayer Communications National Taxpayer Advocate 2002 Annual Report to Congress 198–215.	Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to TAS.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Access to Independent Legal Counsel National Taxpayer Advocate 2002 Annual Report to Congress 198–215.	Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of *amicus* briefs.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	Referred to the Senate
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Taxpayer Advocate Directive National Taxpayer Advocate 2012 Annual Report to Congress 573–602; National Taxpayer Advocate 2002 Annual Report to Congress 419–422.	Amended IRC § 7811 to provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the Internal Revenue Service with respect to any program, proposed program, action, or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Exempt Organizations (EO)				
EO Judicial and Administrative Review National Taxpayer Advocate 2014 Annual Report to Congress 573–602 371-379.	Amend IRC § 7428 to allow taxpayers seeking exemption as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as those seeking exempt status as IRC § 501(c)(3) organizations.			
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division Q § 406 (2015).**			

Other Issues				
Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact National Taxpayer Advocate 2008 Annual Report to Congress 419–422.	Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of $100,000 per individual per year and $200,000 per entity per year for failure to make special disclosures of a "listed transaction."			
Legislative Activity 111th Congress	**Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).**			
	Bill Number	Sponsor	Date	Status
	S 2771	Baucus	11/16/2009	Referred to the Finance Committee
	HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
	S 2917	Baucus	12/18/2009	Referred to the Finance Committee
Eliminate Tax Strategy Patents National Taxpayer Advocate 2007 Annual Report to Congress 512–524.	Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.			
Legislative Activity 112th Congress	**Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).**			
Disclosure Regarding Suicide Threats National Taxpayer Advocate 2001 Annual Report to Congress 227.	Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
Attorney Fees National Taxpayer Advocate 2002 Annual Report to Congress 161–171.	Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees "above the line." Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 703, 118 Stat. 1418, 1546-48 (2004).**			
Attainment of Age Definition National Taxpayer Advocate 2003 Annual Report to Congress 308–311.	Amend IRC § 7701 by adding a new subsection as follows: "Attainment of Age. An individual attains the next age on the anniversary of his date of birth."			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 4841	Burns	7/15/2004	7/21/2004–Passed the House; 7/22/2004–Received in the Senate
Home-Based Service Workers (HBSW) National Taxpayer Advocate 2001 Annual Report to Congress 193–201.	Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Legislative Activity 107th Congress	S 2129	Bingaman	4/15/2002	Referred to the Finance Committee

Restrict Access to the Death Master File National Taxpayer Advocate 2011 Annual Report to Congress 519–523.	Restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	**H.J. Res. 59, 113th Cong. § 203 (2013).**			
Legislative Activity 112th Congress	S 3432	Nelson	7/25/2012	Referred to the Finance Committee
	HR 6205	Nugent	7/26/2012	Referred toS 835the Ways & Means Committee
Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes National Taxpayer Advocate 2012 Annual Report to Congress 521.	Amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a "State".			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 835	Heitkamp	3/23/2015	Referred to the Finance Committee
	HR 1542	Kilmer	3/23/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 835	Johnson	7/09/2014	Referred to the Finance Committee
	HR 1738	Kilmer	6/12/2013	Referred to the Ways and Means Committee
Filing Due Dates of Partnerships and certain Trusts National Taxpayer Advocate 2003 Annual Report to Congress 302.	Amend Internal Revenue Code section 6072(a) to change the regular filing deadline for partnerships described in Section 6031 and trusts described in Section 6012(a)(4) as follows: ◆ For partnerships and trusts making returns on the basis of a calendar year: Change the regular filing deadline from the 15th day of April following the close of the calendar year to the 15th day of March following the close of the calendar year. ◆ For partnerships and trusts making returns on the basis of a fiscal year: Change the regular filing deadline from the 15th day of the fourth month following the close of the fiscal year to the 15th day of the third month following the close of the fiscal year			
Legislative Activity 114th Congress	**Pub. L. No. 114-41 § 2006, 129 Stat. 443, 457 (2015).**			
Foreign Account Reporting National Taxpayer Advocate 2014 Annual Report to Congress 331.	Align the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). Change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938 (including extensions).			
Legislative Activity 114th Congress (July 31, 2015)	**Pub. L. No. 114-41 § 2006, 129 Stat. 443, 458-459 (2015).**			

Individual Taxpayer Identification Numbers (ITINs)	
Requirements for the Issuance of ITINs National Taxpayer Advocate 2008 Annual Report to Congress 126. National Taxpayer Advocate 2010 Annual Report to Congress 319.	Adminisrative recommendation that the IRS should promote the Certified Acceptance Agent program and use other federal agencies to perform acceptance agent duties as contemplated in the Treasury Regulation (*e.g.*, the Postal Service performs a similar service in processing passport applications).
Legislative Activity 114th Congress (July 31, 2015)	**Pub. L. No. 114-113, Division Q § 203 (2015).**
Develop a process to verify that previously issued ITINs have been used for tax administration purposes National Taxpayer Advocate 2008 Annual Report to Congress 126. National Taxpayer Advocate 2010 Annual Report to Congress 319	Administrative recommendation the IRS should develop a process to verify that previously issued ITINs have been used for tax administration purposes and revoke unused ITINs on a regular basis after notifying ITIN holders
Legislative Activity 114th Congress	**Pub. L. No. 114-113, Division Q § 203 (2015).**

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

TAXPAYER RIGHTS IMPACTED[1]

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

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."[2] Thus, if the IRS significantly harms a taxpayer financially and repeatedly ignores his or her concerns, and the taxpayer asks TAS for help, IRC § 7811(d) rewards the IRS and punishes the taxpayer by granting the IRS with more time to make and collect tax assessments. In this way it undermines TAS's mission and the taxpayer's rights to *quality service, finality, privacy (which includes the right to expect that enforcement will be no more intrusive than necessary)*, and *a fair and just tax system*.

The IRS has not implemented statute suspension because its computers cannot reliably track extensions of these periods.[3] It remains impossible to track many of these extensions, including extensions on cases that do not meet TAS's acceptance criteria.[4]

The IRS protects its interests in other ways. If the end of a limitations period is near, the IRS routinely asks the taxpayer to agree to an extension even if TAS is involved. It may also continue enforcement activity on TAS cases, if necessary.[5] Even if TAS issues a TAO ordering the IRS to suspend collection, TAS will generally agree to modify the TAO if collection is in jeopardy.[6] If it does not, the Commissioner, Deputy Commissioner, or National Taxpayer Advocate may nonetheless modify or rescind the TAO.[7]

In addition, IRC § 7811(d) only applies to taxpayers who submit written TAO applications, making it elective for those who know how to avoid it (*e.g.*, by calling TAS) and a trap for those who do

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The periods subject to suspension and the length of any such suspension are subject to a wide variety of interpretations, as discussed below.

3 *See, e.g.*, Memorandum from Commissioner of Internal Revenue, *Taxpayer Advocate Service Statute Suspension Provisions Under IRC Section 7811(d)* (Nov. 10, 2003); Internal Revenue Manual (IRM) 13.1.14, *Suspension of the Statutes of Limitation Under IRC § 7811(d)* (Oct. 31, 2004).

4 Statute suspension does not apply if the application is rejected on the same day it is received. *See* Treas. Reg. § 301.7811-(e)(1).

5 *See, e.g.*, IRM 5.1.9.4.1(8) (June 24, 2014); IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012); *White v. Comm'r*, 899 F. Supp. 767, 773 (D. Mass. 1995).

6 *See, e.g.*, IRM 13.1.20.3.1(5) (Dec. 15, 2007) ("TAS will consider modifying the TAO if there are compelling circumstances that require immediate action by the IRS (*e.g.*, situations where collection is in jeopardy may require the immediate issuance of a Notice of Levy")).

7 IRC § 7811(c).

not.[8] Further, about 54 percent of the taxpayers who requested TAS assistance in writing in fiscal year (FY) 2015 were unrepresented — the taxpayers most likely to get caught in the trap of inadvertently granting the IRS additional time for enforcement.[9] If implemented, the statute suspension would also create uncertainty and disputes about deadlines that would otherwise be clear.

A recent decision by the United States Court of Appeals for the 5th Circuit in *Rothkamm* increases the need for Congress to repeal IRC § 7811(d).[10] The 5th Circuit held that IRC § 7811(d) extended the period for filing a wrongful levy claim, a deadline applicable to a third party. Thus, any third party or taxpayer who misses a statutory deadline (*e.g.*, the deadline to file a wrongful levy claim, to request a refund or a collection due process (CDP) hearing, or to petition the tax court) after applying to TAS may now argue that the application extended his or her deadline. This expansion of IRC § 7811(d) and uncertainty concerning the period(s) to which it applies will exacerbate implementation problems and increase uncertainty and controversy.[11] Congress should repeal IRC § 7811(d), or at least fix it.

EXAMPLES

Example 1: Statute Suspension Could Penalize Taxpayers Who Seek TAS Assistance

Taxpayer A seeks TAS assistance with a collection matter by submitting a Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)* to TAS. Taxpayer B has the same problem but does not seek TAS assistance. While TAS is attempting to resolve Taxpayer A's problem, prior to the issuance of a TAO, the IRS retains the discretion to issue a lien or levy to collect the liability if necessary.[12] Because Taxpayer A's request for TAS assistance triggers IRC § 7811(d)(1), he or she is subject to IRS collection for longer than the normal ten-year period, but Taxpayer B is not.[13] Thus, IRC § 7811(d) penalizes Taxpayer A for seeking TAS assistance.

Example 2: Statute Suspension Will Generate Unnecessary Controversy and Inconsistency

The IRS proposes adjustments to the returns of Taxpayers C, D, and E, and mails a statutory notice of deficiency (SNOD) to each of them on the same day. A SNOD provides a taxpayer with the right to petition the Tax Court if he or she disagrees with the adjustments described in the SNOD and specifies

8 *See, e.g.*, Treas. Reg. §§ 301.7811-1(b) and -1(e)(4).

9 Taxpayer Advocate Management Information System before (TAMIS) query (Oct. 26, 2015).

10 *Rothkamm v. United States*, 802 F.3d 699 (5th Cir. 2015) (hereinafter *Rothkamm*), *rev'g and remanding*, 114 A.F.T.R.2d (RIA) 5919, 2014-2 U.S. Tax Cas. (CCH) 50441 (M.D. La. 2014).

11 *See* Treas. Reg. § 301.7811-1(e); *Rothkamm* at 700 (assuming without discussion that IRC § 7811(d) suspended the period from the date TAS opened the case until the day TAS closed the case).

12 *See, e.g.*, IRM 5.1.9.4.1(8) (June 24, 2014) ("While TAS is attempting to work with the taxpayer to resolve the tax problem, action to collect the tax, such as filing of NFTL or levy, while not prohibited, will generally be suspended. If the RO believes such action is necessary, *e.g.*, the taxpayer is dissipating assets; TAS should be contacted and advised of Collection's plans in advance."); IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012) ("If the RO, Operating Division or Functional Unit refuses to suspend lien filing or levy action, discuss with the Manager whether the issuance of a TAO is appropriate."). *See also White v. Comm'r*, 899 F. Supp. 767, 772 (D. Mass. 1995) (noting a TAO "application merely suspends the running of the period of limitations on collection. It does not immediately suspend the collection activity itself.").

13 IRC § 6502.

the last day for filing.[14] It must also advise the taxpayer of his or her "right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office."[15] None of the taxpayers understand the adjustment or how to file a petition.

Taxpayers C and D both mail Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)*, to TAS on the same day, but Taxpayer E does not. Taxpayer D has proof the IRS received his Form 911 the next day, but Taxpayer C does not. Unbeknownst to them, Taxpayer C and Taxpayer D's forms do not actually reach a TAS office for another 15 and 20 days, respectively, due to security screening and interoffice mail delays. Within one day of receiving the Forms 911 (17 and 22 days, respectively, after receipt by the IRS), TAS determines that Taxpayers C and D are eligible for TAS assistance and assigns a case advocate (CA) to assist them.[16] Three days later (20 and 25 days, respectively, after receipt by the IRS), the CA determines Taxpayers C and D are experiencing a "significant hardship" and sends Operation Assistance Requests (OARs) to the Operating Division (OD) to obtain more information. Twenty-six days later — 30 days after TAS's receipt of each Form 911 (46 and 51 days, respectively, after receipt by the IRS) — the CA receives and reviews the information and determines not to recommend issuing a TAO. Five days later — 35 days after receipt by TAS (51 and 56 days, respectively, after receipt by the IRS), the CA contacts the taxpayers to explain his decision and closes the cases.

Twenty-nine days after the deadline for filing a petition in Tax Court, which is printed on the SNOD, Taxpayers C, D and E each contact a low income taxpayer clinic (LITC). The LITC advises Taxpayer E not to file because his petition would be untimely, but advises Taxpayers C and D to file because they can argue the deadline for filing a petition with the Tax Court was extended by the period the TAO application was pending.[17]

Because Taxpayer C's case is appealable to the 5th Circuit, but Taxpayer D's is not, the Tax Court is more likely to accept Taxpayer C's argument that the period was extended, pursuant to *Rothkamm*, even if it holds that Taxpayer D's is not.[18]

If the court accepts Taxpayer C's or D's argument, it will have to decide how long the TAO application extended the period. The IRS may argue it was extended from TAS's receipt until TAS's determination to accept the case (*i.e.*, by one day for each), from the IRS's receipt until TAS's determination to accept the case (*i.e.*, by 16 or 21 days, for Taxpayers C and D, respectively), from TAS's receipt until its determination that Taxpayers C and D were facing a "significant hardship" and that it would send an OAR and not a TAO (*i.e.*, by three days for each), or from the IRS's receipt until this determination (*i.e.*, by 20 or 24 days for C and D, respectively); whereas Taxpayers C and D may argue it was extended by the period their

14 IRC § 6212; IRC § 6213(a) (providing that taxpayers have 90 days (150 days if they are outside the United States) from the date of the SNOD to petition the Tax Court); IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3463(a), 112 Stat. 685, 767 (1998) (the IRS "shall include on each notice of deficiency under section 6212 … the last day on which the taxpayer may file a petition with the Tax Court.").

15 RRA 98, Pub. L. No. 105-206, § 1102(b), 112 Stat. 685, 703 (1998) (modifying IRC § 6212(a)).

16 The application is not frivolous or subject to a penalty for frivolous submissions. *See* IRC § 6702(b)(2)(B)(ii)(III) (penalty for frivolous TAO applications).

17 *Rothkamm* held that IRC § 7811(d) tolled the period for filing a wrongful levy claim, which by operation of IRC § 6532(c)(2), extended the period for filing suit.

18 Although the Tax Court is a national court with its own precedents, where a case before it is appealable to a circuit court that disagrees with it on a legal issue, it will follow the decision of that court under the so-called *Golsen* rule. *See Golsen v. Comm'r*, 54 T.C. 742, 756-758 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

cases were open in TAS (*i.e.*, by 30 days) or from the IRS's receipt of Form 911 until TAS closed their cases (*i.e.*, by 51 or 56 days, respectively).[19]

Further, the arguments may not be the same for Taxpayers C and D because Taxpayer D retained proof of receipt of Form 911 by the IRS or because Taxpayer D's form traveled more slowly to TAS through IRS security and interoffice mail.[20] Thus, a deadline that was previously clear, evenly applied, and easy to administer may now be unclear, unevenly applied, difficult to administer, and subject to litigation.

Example 3: Statute Suspension Could Be a Trap for the Uninformed

Taxpayers F, G, and H each ask TAS for assistance with collection matters. Taxpayer F seeks assistance by calling. Taxpayer G seeks assistance by filing a Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)*, sending an email, and mailing a letter. Taxpayer H also files Form 911, seeking assistance in resolving a liability due from him and his wife, but he only lists himself as the taxpayer on the Form 911. The IRS does not suspend its collection activity while TAS is evaluating these cases. IRC § 7811(d) only applies to those who submit written TAO applications.[21] As a result, it extends the period for the IRS to collect from Taxpayers H and G, but not Taxpayer F or H's wife.[22] In other words, the IRS has a total of ten years to collect from Taxpayer F and H's wife but more than ten years to collect from Taxpayer H and G.[23]

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19 *Compare* IRC § 7811(d)(1) (applying suspension to the "period beginning on the date of the taxpayer's application … and ending on the date of the National Taxpayer Advocate's decision with respect to such application"), *with Rothkamm* at 700 (assuming without discussion that IRC § 7811(d) suspended the period from the day TAS opened the case until the day TAS closed the case), Treas. Reg. § 301.7811-1(e)(1) (specifying the "period beginning on the date the Ombudsman *receives* an application for a taxpayer assistance order …and ending on the date on which the Ombudsman makes a *determination* with respect to the application") (emphasis added), *and* Treas. Reg. § 301.7811-1(e)(2) (defining the date of the "decision" as "the date on which the taxpayer's request for a taxpayer assistance order is denied, or agreement is reached with the involved function of the Service, or a taxpayer assistance order is issued (except that when the taxpayer assistance order is reviewed by an official who may modify or rescind the taxpayer assistance order … the decision date is the date on which such review is completed).").

20 The filing of forms with TAS is not the same as filing them with the IRS. *See, e.g.*, IRM 13.1.18.6.3, *Taxpayers Delivering Returns to TAS and TAS Date Stamp* (Feb. 1, 2011) ("Any tax return mailed to TAS is not considered filed with the IRS until it is received by an authorized IRS office. As discussed below, there are designated places for filing, and those places do not include a TAS office. Further, the postmark rule described in IRC § 7502 does not apply unless the return was properly addressed to the office with which the return was required to be filed.").

21 *See, e.g.*, Treas. Reg. §§ 301.7811-1(b) and -1(e)(4).

22 *See* Treas. Reg. § 301.7811-1(b) ("A request for a TAO shall be made on a Form 911, 'Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order)' (or other specified form) or in a written statement that provides sufficient information for the Taxpayer Advocate Service (TAS) to determine the nature of the harm or the need for assistance."); Treas. Reg. § 301.7811–1(e)(4) ("The statute of limitations is not suspended in cases where the Ombudsman issues an order in the absence of a written application for relief by the taxpayer or the taxpayer's duly authorized representative."). *See also* IRM 13.1.14.4.3, *Special Situations* (Oct. 31, 2004) ("In situations where only one spouse signs the form or written statement, contact the taxpayer who signed the form or written statement to determine the intent of the application…. TAS will not solicit the taxpayer's signature for the sole purpose of suspending the statute."). Further uncertainty may result if a taxpayer submits a written application, but does not sign it. *Id*.

23 IRC § 6502.

RECOMMENDATIONS

Repeal statute suspension under IRC § 7811(d). Alternatively, clarify that it:

(1) Only extends the period for the IRS to collect or assess a liability, and not the period for the taxpayer or a third party to act; and

(2) Only applies when:

a. Expiration of the relevant statutory limitations period for collection or assessment is imminent (*i.e.*, expires within one year);[24]

b. The taxpayer has declined to extend the applicable limitations period;[25] and

c. The IRS is specifically prohibited by the terms of a TAO from pursuing collection or assessment, as the case may be, for more than seven days.

PRESENT LAW

A TAO Application Extends the Deadline for the IRS to Assess or Collect

In 1988, Congress enacted IRC § 7803(c), renamed the Taxpayer Ombudsman as the National Taxpayer Advocate, and established the Office of the Taxpayer Advocate (referred to as TAS).[26] The National Taxpayer Advocate is the taxpayer's voice at the IRS, and TAS is an independent organization within the IRS that helps taxpayers resolve problems and recommends administrative and legislative changes to mitigate and prevent future problems.[27] Taxpayers are only eligible for TAS assistance if they are facing an economic burden, are impacted by IRS procedures that have failed to operate as intended, or meet other specific criteria, including impairment of their rights under the Taxpayer Bill of Rights (TBOR).[28] Congress provided the National Taxpayer Advocate with the authority to issue TAOs to any office, operating division, or function of the IRS when a taxpayer is experiencing significant hardship as a result of the manner in which the internal revenue laws are being administered.[29]

IRC § 7811(b) describes what a TAO may require, as follows:

> The terms of a Taxpayer Assistance Order may require the Secretary within a specified time period —
>
> (1) To release property of the taxpayer levied upon, or;

24 *See, e.g.*, IRM 5.1.19.5(1) (Jan. 1, 2006) ("An imminent [collection statute expiration date] CSED is any CSED with 12 months or less remaining on the collection statute."); IRM 25.6.23.8.1, *Minimum Time Remaining on ASED* (Mar. 23, 2015) (defining an "imminent" assessment statute expiration date (ASED) in non-Tax Equity and Fiscal Responsibility Act (TEFRA) cases submitted to Centralized Case Processing or Technical Services as ranging from four to 12 months).

25 The IRS will generally not solicit an extension unless the ASED is within 180 days. IRM 25.6.22.2.1, *Assessment* (Aug. 26, 2011).

26 The Office of the Taxpayer Ombudsman was created by the IRS in 1979 to serve as the primary advocate, within the IRS, for taxpayers. This position was codified in the Taxpayer Bill of Rights (TBOR 1), included in the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, Title VI, § 6230, 102 Stat. 3342, 3733 (Nov. 10, 1988). In TBOR 1, Congress added IRC § 7811, granting the Ombudsman (now the National Taxpayer Advocate) the statutory authority to issue TAOs.

27 IRC § 7803(c)(2)(A).

28 *See* IRM 13.1.7.2, *TAS Case Criteria* (Feb. 4, 2015); IRM 13.1.7.2.3 *TAS Case Criteria 8, Best Interest of the Taxpayer* (Feb. 4, 2015).

29 IRC § 7811(b); Treas. Reg. § 301.7811-1(d).

(2) To cease any action, take any action as permitted by law, or refrain from taking any action, with respect to the taxpayer under:

(A) Chapter 64 (relating to collection);

(B) Subchapter B of chapter 70 (relating to bankruptcy and receiverships);

(C) Chapter 78 (relating to discovery of liability and enforcement of title); or

(D) Any other provision of law which is specifically described by the National Taxpayer Advocate in such order.

IRC § 7811(d) describes statute suspension, as follows:

> The running of any period of limitation with respect to any action described in subsection (b) [the terms of a TAO, reprinted above] shall be suspended for —
>
> (1) The period beginning on the date of the taxpayer's application… and ending on the date of the National Taxpayer Advocate's decision with respect to such application; and
>
> (2) Any period specified by the National Taxpayer Advocate in a Taxpayer Assistance Order issued pursuant to such application.

Until recently, the IRS assumed IRC § 7811(d) only extended the period for the IRS to collect or assess tax.[30] By its terms, IRC § 7811(d) suspends "[t]he running of any period of limitation with respect to any action described in subsection (b) [the terms of a TAO]." The flush language of IRC § 7811(b) provides that "[t]he terms of a Taxpayer Assistance Order may require the Secretary…" to take action and not the taxpayer. Thus, IRC § 7811(d) does not appear to extend the deadlines applicable to taxpayers or third

30 *See, e.g.*, IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012).

parties. Legislative history,[31] instructions to Form 911,[32] older court decisions,[33] Treasury Regulation examples,[34] and memos by IRS attorneys are all consistent with this interpretation.[35]

A TAO Application Now Extends the Deadline for Taxpayers to File Wrongful Levy Claims in the 5th Circuit

The United States Court of Appeals for the 5th Circuit recently held in *Rothkamm* that the period of limitations for filing a wrongful levy claim was suspended by a taxpayer's application for a TAO.[36] It focused on the portion of IRC § 7811(d) that says tolling applies to "any statute of limitations for any action described in § 7811(b)." The court suggested that tolling applied to the wrongful levy claim because "releas[ing] property of the taxpayer levied upon," is an action described in IRC § 7811(b)(1). Thus, the court held that an application for a TAO may extend the statutory period for a taxpayer to take action.

31 H. Rept. 100-1104 II at 215 (1988) (Conf. Rept.) ("Any applicable statute of limitations (*e.g.*, the *statute of limitations under sec. 6501 relating to the assessment or collection of tax*) is suspended starting on the date that the taxpayer files an application for a taxpayer assistance order with the Ombudsman and ending on the date that the Ombudsman makes a decision on the taxpayer's application (or a later date if the Ombudsman's order resulting from a taxpayer's application provides for continued suspension of the statute of limitations. The statute of limitations is not suspended in cases where the Ombudsman issues an order in the absence of an application for relief by the taxpayer.") (Emphasis added).

32 Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order*) (2015) ("The signing of this request allows the IRS by law to suspend any applicable statutory periods of limitation relating to the assessment or collection of taxes. However, it does not suspend any applicable periods for you to perform acts related to assessment or collection, such as petitioning the Tax Court for redetermination of a deficiency or requesting a Collection Due Process hearing.").

33 *See Demes v. United States*, 52 Fed.Cl. 365, 373 (Fed. Cl. 2002) ("This provision does not go to the tolling of the statute of limitations in court, but rather confers the IRS with discretion to effect tolling upon a taxpayer's request. Plaintiffs therefore cannot sue in a court for a refund under this provision, nor can the court use it as a basis to toll the statute of limitations in plaintiffs' case."). *See also Next Generation Wireless, Ltd. v. United States*, No. 06–CV–838, 2008 WL 4115516 (S.D. Oh. 2008) (considering only whether the application for a TAO extended the period of limitation for filing a wrongful levy claim under IRC § 6532(c)(2) and ignoring IRC § 7811(d)).

34 All three examples illustrating statute suspension involve the limitations on IRS collection. Treas. Reg. § 301.7811-1(e)(3) (Examples 1-3).

35 *See, e.g.*, IRS Litigation Bulletin (LB) 360, 1990 WL 1086174, 1990 GLB LEXIS 12 (1990) ("The legislative history identifies the limitations period in section 6501 (assessment and collection of tax) as a statute subject to the suspension. Thus, we believe that only those statutes of limitation that would continue to run to the detriment of the Service when an application for a TAO is filed, are subject to the suspension…. We do not believe that section 6511 – limitation on credit or refund – would be suspended."); Program Manager Tech. Adv. (PMTA) 2007-00429, *Suspension of the Statutes of Limitations Under Section 7811(d)* 4 (Mar. 9, 2001) (concluding a broad interpretation of IRC § 7811(d) to toll the period to take "any action" included in a TAO application would be "inconsistent with the statutory language and inconsistent with the examples provided in the regulations…").

36 *Rothkamm* did not directly hold that IRC § 7811(d) extended the period for filing suit. Rather, it held that IRC § 7811(d) extended the period for filing an administrative claim, and that the IRS's denial of the timely-filed administrative claim extended the period for filing suit by operation of IRC § 6532(c)(2). A future decision could clarify that IRC § 7811(d) does not extend jurisdictional deadlines for filing in court, but this case still invites litigation in this area. *Compare Volpicelli v. United States*, 777 F.3d 1042 (9th Cir. 2015) (holding the limitations period for filing suit to challenge a wrongful levy was subject to equitable tolling because it was procedural and not jurisdictional) with *Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000) (holding that the limitations period for filing suit to challenge a wrongful levy was jurisdictional, and thus, not subject to equitable tolling). *Rothkamm* also held that Mrs. Rothkamm was a "taxpayer" for purposes of IRC § 7811(d) because the levy on her assets paid the tax of another. For additional discussion of this case, see Significant Cases, *infra*.

REASONS FOR CHANGE

The IRS Cannot Program Its Computers to Take Advantage of Extended Deadlines Under IRC § 7811(d)

IRC § 7811(d) was enacted in 1988 but not implemented. In 2003, at the National Taxpayer Advocate's request, the IRS Commissioner formally announced the IRS would not implement IRC § 7811(d) because of two major technical difficulties.[37] First, the IRS's Integrated Data Retrieval System (IDRS) could not reflect multiple assessment statute expiration dates (ASEDs) or collection statute expiration dates (CSED) for a husband and wife on a joint liability. For example, if a wife applied for a TAO on a joint liability, but the husband did not, IDRS could not properly reflect an extended ASED or CSED for her without improperly reflecting an extended ASED or CSED for him.

Second, the codes the IRS uses to update IDRS (called transaction codes) could not update a single tax year to reflect multiple CSEDs for different assessments. For example, assume a taxpayer timely reported an unpaid liability on her 2009 return filed on April 15, 2010, which the IRS could collect for ten years (*i.e.*, until April 15, 2020). Two years later, the IRS audited the 2009 return and on April 15, 2012, assessed another liability, which it could collect for ten years (*i.e.*, until April 15, 2022). If the taxpayer later applied for a TAO, triggering a nine-month extension of the CSED for both assessments, TAS could not properly update both CSEDs on IDRS. If TAS tried to update IDRS to extend them, IDRS would incorrectly move the CSED for the first 2009 assessment (from the balance due return) to equal the CSED for the audit adjustment for 2009 that occurred two years later (*i.e.*, from 2020 to 2022), and then add nine months to both CSEDs. As a result, IDRS would incorrectly show that the IRS had an additional two years (*i.e.*, 12 years and nine months) to collect the first assessment.[38]

In other words, the IRS could not accurately track the extensions of the ASED and CSED, as required by IRC § 7811(d). Although IDRS may now be able to reflect different ASEDs and CSEDs for each spouse, it is still unable to extend the CSED correctly when multiple assessments apply to the same year, as illustrated above.[39]

Statute Suspension Is Not Needed to Protect the Government

U.S. Appeals Court for the 5th Circuit Judge Higginbotham's dissent in *Rothkamm* quoted various authorities for the following proposition:

> All suspension provisions [including 7811(d)] are designed and intended to avoid prejudice to the IRS's ability to collect during periods of time in which collection or assessment is prohibited [or otherwise impeded][40]

37 *See, e.g.*, Memorandum from Commissioner of Internal Revenue, *Taxpayer Advocate Service Statute Suspension Provisions Under IRC Section 7811(d)* (Nov. 10, 2003); IRM 13.1.14, *Suspension of the Statutes of Limitation Under IRC § 7811(d)* (Oct. 31, 2004).

38 National Taxpayer Advocate FY 2003 Objectives Report to Congress, App. V, 4 (*Suspension of Statute of Limitations Periods*). See also IRM 5.19.10.4.5(3) (Feb. 1, 2014) ("Input of TC 550 will update all CSEDs on the module to the same date. Care must be taken when inputting a TC 550 to a module with multiple CSEDs. If correcting one CSED will cause the other CSEDs to be incorrect, then a TC 550 cannot be done.").

39 *See* IRM 5.19.10.4.5, *Resolving a Module with CSED Problems* (Feb. 1, 2014).

40 *Rothkamm* at 717 n.14. (quoting *In re Turner*, 182 B.R. 317, 329 (Bankr. N.D. Ala. 1995), *adhered to on reconsideration*, 195 B.R. 476 (Bankr. N.D. Ala. 1996) and citing *In re Gore*, 182 B.R. 293, 304 (Bankr. N.D. Ala. 1995)).

No legislative history addresses why IRC § 7811(d) was enacted.[41] However, it seems to address concerns expressed by IRS Commissioner Egger in 1981 that granting an independent Ombudsman (the predecessor to the National Taxpayer Advocate) legal authority to stop collection activity could "seriously impair the Service's ability to collect revenue."[42] These concerns have not materialized.

As the government has not implemented IRC § 7811(d), it has found other ways to protect its interests. The IRS routinely asks the taxpayer to agree to extend limitations periods even if TAS is assisting them. Moreover, the IRS is not required to suspend enforcement while TAS is evaluating an application for a TAO.[43] Even if TAS issues a TAO ordering the IRS to suspend enforcement, TAS will generally agree to modify the TAO if collection is in jeopardy and if it does not, the IRS Commissioner or Deputy Commissioner may nonetheless modify or rescind the TAO.[44] Thus, the government can protect its interests without statute suspension.

The Automatic Statute Suspension Period Will Be Subject to Dispute

Under IRC § 7811(d)(1) statute suspension applies to the "period beginning on the date of the taxpayer's application… and ending on the date of the… decision with respect to such application."[45] Treas. Reg. § 301.7811-1(e)(1) specifies that the period begins on the date TAS "receives an application for a taxpayer assistance order"[46] and ends on the date TAS "makes a determination with respect to the application." Thus, the National Taxpayer Advocate's position is that the suspension period ends when TAS makes its first determination.

TAS makes a number of determinations on TAO applications.[47] It first determines whether the taxpayer qualifies for TAS assistance based on TAS's case acceptance criteria. For 99 percent of the cases that TAS

41 Technical and Miscellaneous Revenue Act of 1988 (TBOR I), Pub. L. 100–647, Title VI, § 6230(a), 102 Stat. 3733 (Nov. 10, 1988) (enacting IRC § 7811(d)).

42 *Taxpayers' Bill of Rights: Hearings Before the Subcomm. on Oversight of the Internal Rev. Serv. of the S. Comm. on Fin. on S. 850*, 97th Cong. 57 (June 2, 1981) (Statement of Roscoe L. Egger, Jr., Commissioner of Internal Revenue), *reprinted at* http://www.unclefed.com/TxprBoR/1981/81Egger.html.

43 *See, e.g.*, IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012) ("If the RO, Operating Division or Functional Unit refuses to suspend lien filing or levy action, discuss with the Manager whether the issuance of a TAO is appropriate."). *See also White v. Comm'r*, 899 F. Supp. 767, 773 (D. Mass. 1995) (noting a TAO "application merely suspends the running of the period of limitations on collection. It does not immediately suspend the collection activity itself.").

44 *See, e.g.*, IRC § 7811(c) (permitting the Deputy Commissioner or Commissioner to modify or rescind a TAO, even if issued directly by the National Taxpayer Advocate); IRM 13.1.20.3.1(5) (Dec. 15, 2007) ("TAS will consider modifying the TAO if there are compelling circumstances that require immediate action by the IRS (*e.g.*, situations where collection is in jeopardy may require the immediate issuance of a Notice of Levy).").

45 The statute says the date of the "National Taxpayer Advocate's decision." Under IRC § 7811(f), however, the term "National Taxpayer Advocate" includes any designee of the National Taxpayer Advocate. The National Taxpayer Advocate has delegated her TAO authority to Area Directors, Local Taxpayer Advocates, the Executive Director, Case Advocacy, and the Deputy National Taxpayer Advocate. Treas. Reg. § 301.7811–1(a)(2); IRM 1.2.50.2, *Delegation Order 13-1 (Rev. 1)* (Mar. 17, 2009); IRM 13.1.20.2, *Determining When to Issue a Taxpayer Assistance Order* (Feb. 1, 2011).

46 Particularly in cases where there is a significant delay between the date the taxpayer mailed the application and the date TAS received it, the date the suspension period begins could be subject to dispute, as illustrated by the example above. Disputes may also arise when TAS receives a TAO application originally delivered to the IRS and not TAS because TAS and the IRS are sometimes treated as separate entities for purposes of filing. *See, e.g.*, IRM 13.1.18.6.3, *Taxpayers Delivering Returns to TAS and TAS Date Stamp* (Feb. 1, 2011) ("Any tax return mailed to TAS is not considered filed with the IRS until it is received by an authorized IRS office. As discussed below, there are designated places for filing, and those places do not include a TAS office. Further, the postmark rule described in IRC § 7502 does not apply unless the return was properly addressed to the office with which the return was required to be filed.").

47 *See, e.g.*, IRM 13.1.18.1, *Processing Taxpayer Advocate Service (TAS) Cases* (Feb. 1, 2011).

accepted and closed in FY 2015, it made this determination and entered them into its case management system (called the Taxpayer Advocate Management Information System (TAMIS)) within four days.[48] Because TAS does not currently track cases that it does not accept (*i.e.*, because they do not meet TAS criteria), it is impossible to track many of these short extensions.[49]

TAS employees must also determine whether the taxpayer is facing a significant hardship before taking action (*i.e.*, issuing an OAR, a TAO, or closing the case).[50] For 77 percent of the cases that TAS closed in FY 2015, it made the significant hardship determination within seven days.[51] Because a taxpayer's circumstances can change, TAS may make more than one significant hardship determination during the course of its assistance.

Once TAS makes its first determination, which is usually a determination about whether to accept the case, the suspension period should end, even if TAS later determines the taxpayer is experiencing a significant hardship, determines to issue an OAR instead of a TAO, determines to issue a TAO, or determines to close the case. The taxpayer may not always be informed of the operative date and it is likely to be subject to dispute.[52] However, the United States Court of Appeals for the 5th Circuit held in *Rothkamm*, *without any analysis*, that the period ended on the day TAS closed its case.

To reduce burden to taxpayers and the IRS of tracking short extensions, the National Taxpayer Advocate previously recommended legislation to create an exception to statute suspension in cases where the extension would be for seven days or less.[53] This would help reduce controversy surrounding extensions that are less likely to be important and that may not even be possible to track unless accepted under TAS case acceptance criteria. However, confusion and litigation will likely continue until Congress repeals or clarifies IRC § 7811(d).

Statute Suspension Could Penalize Taxpayers for Seeking Assistance

If statute suspension were applied in cases where IRS enforcement was not actually suspended, then taxpayers who come to TAS would be at a disadvantage. They would be subject to enforcement for longer periods than taxpayers who did not come to TAS.

48 TAMIS Query (Nov. 23, 2015).

49 Statute suspension does not apply if the application is rejected on the same day it is received. *See* Treas. Reg. § 301.7811-(e)(1) ("For the purpose of computing the period suspended, all calendar days except the date of receipt of the application shall be included.").

50 *See, e.g.*, IRM 13.1.18.1, *Processing Taxpayer Advocate Service (TAS) Cases* (Feb. 1, 2011).

51 TAMIS Query (Nov. 23, 2015). It made the significant hardship determination within 23 days in 90 percent of its closed cases and within 90 days in 99 percent for FY 2015.

52 Treas. Reg. § 301.7811-1(e)(2) defines the date of the "decision" as "the date on which the taxpayer's request for a taxpayer assistance order is denied, or agreement is reached with the involved function of the Service, or a taxpayer assistance order is issued (except that when the taxpayer assistance order is reviewed by an official who may modify or rescind the taxpayer assistance order… the decision date is the date on which such review is completed)." Some may argue that this regulatory language suggests an earlier decision or determination by TAS (*e.g.*, a determination regarding eligibility for TAS assistance or significant hardship) may not end the suspension period, as illustrated above, particularly in cases where TAS issues a TAO.

53 In response to this proposal, Rep. Lewis sponsored H.R. 586, 107th Cong § 224 (2001), which passed the House and was referred to the Senate on April 18, 2002; Rep. Houghton sponsored H.R. 3991, 107th Cong. Title II § 204 (2001), which was defeated in the House on March 19, 2002; and Rep. Portman sponsored H.R. 1528, 108th Cong. § 106 (2003), which passed the Senate on May 19, 2004. See National Taxpayer Advocate 2002 Annual Report to Congress 159.

Perhaps for this reason, some Chief Counsel attorneys have even suggested that the IRS cannot rely on IRC § 7811(d) unless IRS enforcement activity was actually prohibited by internal procedures.[54] However, this view was limited to a specific fact pattern and is not necessarily the IRS's current official position. If statute suspension penalizes taxpayers from seeking assistance from TAS, then it encumbers the taxpayer's *right to quality service, finality, privacy* (which includes the right to expect that enforcement will be no more intrusive than necessary), and *to a fair and just tax system*.

Statute Suspension Is a Trap for the Uninformed and Elective for Others

Statute suspension only applies to those who submit written TAO applications to TAS or who are granted TAOs that expressly provide for statute suspension.[55] Well-informed taxpayers who know that statute suspension only applies to written TAO applications could take advantage of its electivity. To avoid giving the IRS more time for enforcement, they could simply request TAS assistance by phone.[56] By contrast, similarly situated but uninformed taxpayers who file Forms 911 could be subject to IRS enforcement for longer periods.

Statute Suspension Could Affect Thousands Each Year

TAS received 227,189 cases in FY 2015.[57] Of these, 37,484 were opened in response to correspondence from the taxpayer.[58] A sample of TAS cases received in FY 2008 found that about 49.2 percent of those received by correspondence included Form 911.[59] Assuming taxpayers submitted Forms 911 at about the same rate in FY 2015, statute suspension could apply to 18,442 taxpayers in FY 2015 alone (37,484 x 49.2 percent). Further, about 54 percent of the taxpayers who asked for TAS assistance by correspondence in FY 2015 were unrepresented — or potentially 9,959 of the 18,442 who may have been subject to statute suspension.[60] Unrepresented taxpayers are the least likely to be aware that they may have inadvertently granted the IRS additional time to assess or collect their liabilities.

Statute Suspension Could Frustrate TAS's Mission

If TAS were to level the playing field by requiring a signed TAO application (thereby triggering statute suspension) before accepting a case, then statute suspension could discourage taxpayers who need help from seeking assistance, frustrating TAS's mission. Such a policy could also prevent TAS from offering prompt assistance to taxpayers by phone, particularly those without immediate access to the technology required to submit a written TAO application electronically (*e.g.*, a fax machine or scanner and Internet access). Legislation could clarify that written TAO applications are not required to trigger statute suspension, but then TAS would need to ensure taxpayers are aware that even a request by phone could suspend the statute, potentially discouraging taxpayers from seeking assistance.

54 IRS CCA 199910043, 1999 IRS CCA LEXIS 99 (Jan. 14, 1999) ("the Service may rely on IRC § 7811(d) and B.C. § 105(a) to toll the periods only where, pursuant to its own internal procedures, the Service was prohibited from collecting the taxes it seeks to have declared priority or nondischargeable and actually made no attempt to collect those taxes. Additionally, courts may well require evidence of abuse of the system by the debtor, *e.g.*, that the application was filed as a delaying tactic.").

55 *See, e.g.*, Treas. Reg. 301.7811-1(b) and -1(e)(4).

56 *Id*.

57 TAMIS query (Oct. 26, 2015).

58 *Id*.

59 TAS Technical Analysis and Guidance, *Special Study* (Dec. 2010).

60 TAMIS query (Oct. 26, 2015).

Statute Suspension Will Generate Litigation

A TAO application may now extend the period for taxpayers and third parties to take action, at least in the 5th Circuit under *Rothkamm*. Some taxpayers could file TAO applications because they want more time to meet statutory deadlines. A more likely scenario, however, is that those who seek TAS assistance and later discover they missed an important deadline will argue the deadline was extended by IRC § 7811(d).[61]

The IRS May Now Feel Obligated to Implement Statute Suspension

Some IRS attorneys concluded that the IRS was not legally required to implement statute suspension because IRC § 7811(d) only protects the IRS and does not extend periods applicable to taxpayers.[62] Because *Rothkamm* has questioned that assumption, the IRS may now feel a greater obligation to implement it notwithstanding the technical difficulties and inequities of doing so.

Implementation of IRC 7811(d) Would Be More Difficult If Applied to Taxpayer Deadlines

As described above, the IRS's computer systems cannot accurately reflect the ASED and CSED extensions provided by IRC § 7811(d). These difficulties would multiply if the IRS were also required to track the extension of statutory deadlines applicable to taxpayers. For example, there is no obvious way for employees to change the refund statute expiration date (RSED) or filing deadline for a CDP hearing that is reflected on IRS systems.[63] Moreover, it is not even clear which taxpayer deadlines would be extended under *Rothkamm*. Although taxpayers will argue that under the reasoning of *Rothkamm* "any" statutory deadline, including jurisdictional ones, can be extended by operation of IRC § 7811(d), the court in *Rothkamm* only held that IRC § 7811(d) extended the period for a third party to file a wrongful levy claim with the IRS.[64]

EXPLANATION OF RECOMMENDATIONS

TAS helps taxpayers resolve problems with the IRS when they are facing an economic burden as a result of IRS action or inaction, or when the IRS is ignoring their facts and circumstances and creating devastating problems for them. IRC § 7811(d) operates primarily, if not solely, to penalize taxpayers for seeking assistance from TAS and to reward the IRS for creating those problems by awarding it with additional time for

61 Although frivolous TAO applications could trigger a frivolous submissions penalty, a submission by a taxpayer facing a potentially significant hardship under IRC § 7811(a)(2) (*e.g.*, incurring significant costs (including fees for professional representation) if relief is not granted) is unlikely to be frivolous. *See* IRC § 6702(b)(2)(B)(ii)(III) (penalty for frivolous TAO applications).

62 *Compare* LB 360, 1990 WL 1086174, 1990 GLB LEXIS 12 (1990) (concluding that because IRC § 7811(d) only protects the IRS by tolling collection and assessment periods, the IRS was not legally required to implement it), *with* PMTA 2007-00429, *Suspension of the Statutes of Limitations Under Section 7811(d)* (Mar. 9, 2001) (assuming statute suspension only applies to protect the IRS's interest but still declining to conclude its implementation was not mandatory). Further, the 5th Circuit decision stated that the IRS has no discretion under IRC § 7811(d). *Rothkamm* at 713 ("Congress did not provide the IRS with that discretion under § 7811(d), and the only discretion granted in the regulations is the discretion granted to the Ombudsman to lengthen the period of tolling beyond the date of the decision on the TAO application.").

63 *See, e.g.*, IRM 25.15.15, *Mirror Modules for Requests for Relief from Joint and Several Liability* (July 30, 2014) (discussing RSEDs) and IRM 21.5.6.4.8, *-D Freeze* (Mar. 3, 2014) (same); IRM 5.19.4, *Enforcement Actions* (Nov. 26, 2014) (discussing CDP filing deadline).

64 If IRC § 7811(d)(1) was inapplicable, Mrs. Rothkamm's suit would have been over seven months late, but her case was open in TAS for less than six months, according to the court. Had the court held that IRC § 7811(d)(1) merely extended the time for filing suit, the suit would still have been late. Rather, the court held that the suit was timely only because IRC § 7811(d)(1) extended the period for her to file an administrative claim. The IRS's consideration and subsequent denial of her timely-filed administrative claim extended the period for filing suit by operation of IRC § 6532(c)(2). As noted above, a future decision could clarify that IRC § 7811(d)(1) does not extend jurisdictional deadlines for filing in court.

enforcement, thereby undermining taxpayer rights and TAS's mission. It throws previously clear rules and deadlines into disarray in an inconsistent, elective, and arbitrary manner. It invites litigation over which deadlines it extends and for how long. It requires the IRS to track unspecified changes to unspecified deadlines that the IRS does not and cannot track, even if it could identify all of the deadlines it should track and what changes it should make to them. For these reasons, IRC § 7811(d) must be repealed.

In the alternative, if IRC § 7811(d) cannot be repealed, then Congress could address some of the problems with IRC § 7811(d) by clarifying that it only suspends the periods for collection or assessment and only applies in cases where it is most likely to be relevant. It is most likely to be relevant only when a TAO specifically and explicitly bars enforcement for more than seven days, expiration of the relevant statutory limitations period is imminent (*i.e.*, would otherwise expire within one year), and the IRS has asked the taxpayer to extend the applicable limitations period but the taxpayer has declined. Such situations should be rare because taxpayers who are working with TAS almost always agree to extend the limitations period upon request. To reiterate, however, the National Taxpayer Advocate's primary recommendation is to repeal IRC § 7811(d).

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

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

PROBLEM

The IRS has the authority to correct math or clerical errors — arithmetic mistakes and the like — on a return using summary assessment (or "math error") procedures.[2] When it makes a summary assessment, taxpayers cannot obtain judicial review before paying, unless they can determine whether and how to respond to an often-confusing IRS notice more quickly than under regular deficiency procedures.[3] The IRS has had problems using its summary assessment authority to address discrepancies and mismatches that go beyond simple arithmetic mistakes.[4] Yet, the Administration has proposed legislation that would allow the Treasury Department to expand the IRS's summary assessment authority to other "correctable" errors by regulation — without specific authorization from Congress — where:

1. The information provided by the taxpayer does not match the information contained in government databases;
2. The taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or
3. The taxpayer has failed to include with his or her return documentation that is required by statute.[5]

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Internal Revenue Code (IRC) §§ 6213(b), (g)(2).

3 *Compare* IRC § 6211(a) *with* IRC § 6213(b)(2).

4 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 91-2; National Taxpayer Advocate 2011 Annual Report to Congress 74; National Taxpayer Advocate 2006 Annual Report to Congress 311; National Taxpayer Advocate 2003 Annual Report to Congress 113; National Taxpayer Advocate 2002 Annual Report to Congress 25, 186; National Taxpayer Advocate 2001 Annual Report to Congress 33. *See also Hearing on Improper Payments in the Administration of Refundable Tax Credits Before the Subcommittee on Oversight, Committee on Ways and Means*, 112th Cong. (May 25, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Hearing on Complexity and the Tax Gap, Making Tax Compliance Easier and Collecting What's Due Before the Committee on Finance*, 112th Cong. (June 28, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Hearing on The National Taxpayer Advocate's 2014 Annual Report to Congress, Before the House Subcomm. on Gov't Ops., Comm. on Oversight and Gov't Reform*, 114th Cong. (Apr. 15, 2015) (statement of Nina E. Olson, National Taxpayer Advocate).

5 Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, February 2015, at 245-246, *available at* http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. For concerns about this proposal, see, *e.g.*, *Hearing on The National Taxpayer Advocate's 2014 Annual Report to Congress, Before the House Subcomm. on Gov't Ops., Comm. on Oversight and Gov't Reform*, 114th Cong. (Apr. 15, 2015) (statement of Nina E. Olson, National Taxpayer Advocate).

This proposal would allow the IRS to assume a taxpayer's return is wrong and assess a tax deficiency based on circumstances that are more complicated than they appear.

If the IRS uses summary assessment procedures to address complex issues that require additional fact finding, the assessments are more likely to be wrong, and confusing math error notices are likely to become even more difficult to understand.[6] Confusing notices may prevent some taxpayers, particularly low income taxpayers, from responding timely. Those who miss the deadline lose the right to challenge the adjustment in court before paying. The IRS also wastes resources when its assessments are inaccurate because it has to review additional documentation, process abatement requests and amended returns, try to respond to calls and letters, and potentially even attempt to collect inaccurate assessments from taxpayers who are entitled to the benefits they claimed. Thus, expanding summary assessment procedures into more complicated areas could erode the *rights to quality service, to pay no more than the correct amount of tax, to privacy, to challenge the IRS's position and be heard, to appeal an IRS decision in an independent forum*, and *to a fair and just tax system*, while wasting IRS resources.

EXAMPLES

Example 1: Unreliable Database Mismatches Could Trigger Math Error Authority

Not all government databases are reliable for tax purposes. The IRS has the authority to assess tax using math error procedures when a taxpayer claims the Earned Income Tax Credit (EITC) for a child who is shown on the Federal Case Registry (FCR) as being in someone else's custody.[7] A study that Congress required the Treasury Department to undertake with the National Taxpayer Advocate found that *about 39 percent* of the returns selected solely based on FCR data mismatches were actually correct.[8] Because FCR data is not sufficiently reliable, the IRS has adopted the National Taxpayer Advocate's recommendation not to assess math errors based on mismatches between returns and FCR data.[9]

Example 2: Mismatches Could Allow the IRS to Make Summary Assessments Based on the IRS's Estimate of the Mere Probability of an Error

The IRS's "Dependent Database" (DDb), combines unreliable data from the FCR with other more reliable government data (*e.g.*, the Social Security Administration's Kidlink data, which links a child's Social Security number (SSN) to its mother's SSN, and in many instances, the father's SSN).[10] The IRS runs each return that claims a dependent or other family-status benefit through DDb filters (*e.g.*, EITC,

6 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163.

7 In 2001, Congress authorized the IRS to use of summary assessment procedures to deny EITC, beginning in 2004, where data from the FCR of Child Support Orders indicates the taxpayer claiming a child is actually the non-custodial parent. *Economic Growth and Tax Relief Reconciliation Act of 2001*, Pub. L. No. 107-16, § 303(g), 115 Stat. 38, 56-57 (2001) (codified at IRC § 6213(g)(2)(M)). The House Conference Report requested a study of the FCR database by the Department of Treasury, in consultation with the National Taxpayer Advocate, of the accuracy and timeliness of the data in the FCR; the efficacy of using math error authority in this instance in reducing costs due to erroneous or fraudulent claims; and the implications of using math error authority in this instance, given the findings on the accuracy and timeliness of the data. H.R. Conf. Rep. 107-84 at 147 (2001). *See also* National Taxpayer Advocate 2002 Annual Report to Congress 189 (Legislative Recommendation: *Math Error Authority*).

8 *See* IRS, Federal Case Registry Final Report, Project 5-02-12-3-005 (CR-39) (July 2003) ("almost 39% of the FCR children were allowed per examination… With the exclusion of no reply cases… the rate of FCR children that are allowed per examination increases to 53.5%").

9 It is not clear that the IRS would have conducted the FCR study without a mandate to do so.

10 For a description of the DDb, see Internal Revenue Manual (IRM) 4.19.14, *EITC/Revenue Protection Strategy* (Jan. 1, 2015). Exam receives a majority of its EITC work from the DDb. IRM 4.19.14.1, *Earned Income Tax Credit (EITC) Revenue Protection Strategy (RPS)* (Jan. 1, 2015).

dependent exemptions, filing status, Child and Dependent Care Credit, Child Tax Credit, and education benefits, etc.).[11]

The IRS assumes that the more inconsistencies (or "mismatches") there are between the return and the DDb (or the more "rules" it breaks) the more likely the return is to contain errors.[12] In other words, the IRS uses the DDb to infer the probability of error, but it is not a binary (yes/no) determination. TAS has seen instances where a return has broken all of the rules contained in the DDb and the taxpayer is still eligible for the exemption or credit claimed. It would be unprecedented to give the IRS summary assessment authority based on some unstated *probability* that it is correct. Yet, because the DDb is a government database that the IRS may consider to be inconsistent with a return, there is a potential it could be used in this way under the correctable error proposal.

Example 3: The IRS Does Not Try to Reconcile Inconsistencies Before Charging a Math Error

The IRS may assess tax using math error procedures when a taxpayer claims a dependent, but does not include the dependent's correct taxpayer identification number (TIN).[13] Because a TIN is a long string of numbers, taxpayers sometimes enter them incorrectly. A TAS study of math errors on dependent TINs found that the IRS subsequently reversed at least part of these math errors on 55 percent of the returns with incorrect TINs.[14] The study also found that the IRS could have resolved 56 percent of these errors using information already in its possession (*e.g.*, the TIN listed on a prior year return), rather than assessing tax using math error procedures and asking the taxpayer to explain the apparent discrepancy.[15]

Even when the taxpayer did not respond and the IRS did not reverse the math error, the TAS study found that the IRS should have reversed it in 41 percent of the cases based on information in its files, and thus, it deprived taxpayers of benefits to which they were entitled.[16] The IRS's failure to review information in its files before assessing tax using math error procedures is inconsistent with general direction from Congress that the IRS should use information in its possession to avoid using the summary assessment process, rather than resolving uncertainty against the taxpayer.[17] In other words, in a large percentage of

11 The IRS also uses the DDb filters to detect potential identity theft. As of November 26, 2015, the DDb filters used by the IRS's Taxpayer Protection Program (TPP) had a "false positive" rate of 38.2 percent during calendar year 2015. *See* IRS, Return Integrity & Compliance Services (RICS), *Update of the Taxpayer Protection Program (TPP)* 9 (Dec. 2, 2015). According to the IRM, the TTP "is responsible for handling potential Identity Theft (IDT) cases that are scored by a set of IDT models in the DDb or selected through a query in the Electronic Fraud Detection System (EFDS) or selected by Integrity & Verification Operation (IVO) tax examiners during the daily screening process." IRM 25.25.6.1, *Taxpayer Protection Program* (May 26, 2015).

12 *See generally* IRM 4.19.14, *EITC/Revenue Protection Strategy* (Jan. 1, 2015).

13 IRC § 6213(g)(2)(H).

14 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 114, 117 (Research Study: *Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*).

15 *Id*. at 119-20.

16 *Id*. at 120.

17 H.R. Rep. No. 94-658, at 290 (1976) ("…care should be taken to be sure that what appears to be an error in addition or subtraction is not in reality an error in transcribing a number from a work sheet, with the final figure being correct even though an intermediate arithmetical step on the return appears to be wrong… It is expected that the Service will check such possible sources of arithmetical errors before instituting the summary assessment procedures."). *Id* at 291 ("[T]he taxpayer has the obligation of showing that he or she is entitled to the number of exemptions claimed. However, this summary assessment procedure is not to be used where the Service is merely resolving an uncertainty against the taxpayer."). The 1976 committee report provided detailed direction from Congress about how it generally expected the IRS to apply the math error rules, however, the IRS was not expressly authorized to use the math error procedure to address the omission of a dependent's TIN on a return until 1996. *See* Small Business Job Protection Act of 1996, Pub. L. No 104-188, § 1615, 110 Stat. 1853 (1996); H.R. Rep. No. 104–737, at 319-20 (1996).

math error cases the IRS imposed a burden on taxpayers, generating phone calls and letters it could not timely handle, triggering interest charges and denying tax benefits to those entitled to them, rather than investing a few minutes of research at the front end. Under the correctable error proposal, the IRS could burden taxpayers and waste more resources in this way.

Example 4: It May Be Difficult to Determine What Documentation Is Attached

Congress authorized the IRS to use math error authority to deny the First-Time Homebuyer Credit (FTHBC) to taxpayers who did not attach a "settlement statement," as required.[18] Initially, the IRS accepted a settlement statement as sufficient only if it showed all parties' names and signatures, the property address, sales price, and date of purchase, as provided on the Form HUD-1. After learning that not all states required a settlement statement to include a complete address or both parties' signatures, the IRS reversed its position.[19]

The IRS's continued use of math error authority in this circumstance would have been very costly and burdensome.[20] To make determinations about the sufficiency of a settlement statement, an IRS employee would have to read papers attached to the return and explain any problems to the taxpayer (or summarily assess the liability without providing a good explanation). Accordingly, the National Taxpayer Advocate recommended the IRS be permitted to use math error authority only when a return does not contain a document that purports to be a settlement statement (*i.e.*, a simple yes/no determination), and required to use normal deficiency procedures to address facts-and-circumstances determinations concerning the *sufficiency* of a settlement statement.[21] Yet, under the correctable error proposal, after promulgating regulations, the IRS could summarily assess tax related to any return that did not attach sufficient documentation in similarly ambiguous circumstances.

18 *See* Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, § 11, 123 Stat. 2984, 2991-92 (2009), *amending* IRC § 36(d) and *adding* IRC § 6213(g)(2)(P).

19 The IRS's handling of FTHBC issues in the 2011 filing season delayed processing of an estimated 128,000 returns and led to a sharp increase in related TAS cases (from 669 through April 30 of fiscal year (FY) 2010 to 4,299 for the same period in FY 2011). National Taxpayer Advocate FY 2012 Objectives Report to Congress 28-36. IRS SERP Alert 100290 (May 25, 2010); IRM 21.6.3.4.2.11.6(4) (May 7, 2012) ("The settlement statement may or may not contain the buyer(s) and seller(s) signatures."). *See also* IRS SERP Alert 100066 (Feb. 12, 2010); IRS Instructions for Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit* 2 (Mar. 2011) (acknowledging that not all taxpayers will have a signed HUD-1).

20 It would also have been inconsistent with concerns expressed by Congress in 1976. *See* H.R. Rep. No. 94-658, at 292 n.1 (1976) ("[D]isputes as to the adequacy of the schedule that the taxpayer submits are to be dealt with under normal administrative procedures and not by use of the extraordinary summary assessment procedure.").

21 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 524-30 (Legislative Recommendation: *Mandate That the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

RECOMMENDATIONS

To ensure that the IRS's use of summary assessment authority does not impair taxpayers' rights and unnecessarily burden both the taxpayer and the IRS, the National Taxpayer Advocate recommends (and reiterates prior recommendations) that Congress authorize the IRS to summarily assess a deficiency only if:[22]

1. There is a mismatch between the return and unquestionably reliable data (rather than the IRS's estimate about the mere probability of an error).
2. The IRS's math error notice clearly describes the discrepancy and how taxpayers may contest the proposed change.
3. The IRS has researched all of the information in its possession (*e.g.*, information provided on prior-year returns) that could reconcile the apparent discrepancy.
4. The IRS does not have to analyze facts and circumstances or weigh the adequacy of information submitted by the taxpayer (*e.g.*, whether *sufficient* documentation is attached) to determine if the return contains an error.
5. The abatement rate for a particular issue or type of inconsistency is below a specified threshold for those taxpayers who respond.[23]
6. For any new data or criteria, the Department of Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported to Congress on the reliability of the data or criteria for purposes of assessing tax using math error procedures.[24] The report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs to taxpayers (*e.g.*, time, paperwork, representation) and the IRS (*e.g.*, processing taxpayer calls and letters, requests for audit reconsideration, amended returns, appeals, and TAS intervention).

PRESENT LAW

Taxpayers Generally Have the Right to Judicial Review *Before* Paying an Assessment by the IRS

Before assessing a deficiency (*e.g.*, as a result of an audit), the IRS is legally required to send the taxpayer a Statutory Notice of Deficiency (SNOD), also known as a "90-day letter."[25] This letter explains the basis for the deficiency and gives the taxpayer 90 days to file a petition with the Tax Court.[26] A taxpayer who misses this deadline can only seek judicial review by paying the assessment and filing a claim for refund.[27]

22 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 284 (Legislative Recommendation: *Taxpayer Rights: Codify Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections*); National Taxpayer Advocate 2011 Annual Report to Congress 524-530 (Legislative Recommendation: *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*); National Taxpayer Advocate 2002 Annual Report to Congress 189 (Legislative Recommendation: *Math Error Authority*).

23 An issue should not be subject to math error simply because the population in question is relatively unresponsive, *e.g.*, because they do not understand the IRS's notices or are transient and do not receive them.

24 As noted above, in 2001 Congress requested a study of the FCR database by the Department of Treasury, in consultation with the National Taxpayer Advocate. H.R. Conf. Rep. 107-84, at 147 (2001).

25 Prior to the issuance of the SNOD, the IRS will generally issue a 30-day letter giving the taxpayer the opportunity to file a protest with Appeals. IRS, Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund* 5 (Sept. 2013).

26 IRC § 6213. The 90-day period becomes 150 days if the notice is addressed to a person outside of the United States.

27 If the claim is denied or if no action is taken on the claim within six months, the taxpayer may file a refund suit in a federal district court or the Court of Federal Claims within the limitations period. IRC §§ 6511, 6532, 7422.

Low income taxpayers are less likely to be able to afford to pay the assessment before disputing it or to navigate these more complicated procedures.

Taxpayers Do Not Automatically Receive the Right to Judicial Review Before Paying a Math Error Assessment

IRC §§ 6213(b) and (g) authorize the IRS to use its math error authority to assess and collect tax after 60 days without first providing the taxpayer access to the Tax Court. To preserve the right to petition the Tax Court, the taxpayer must request an abatement within 60 days. If the taxpayer does so, the IRS will then work the case through normal deficiency procedures (described above). Although initially limited to situations involving mathematical errors (*e.g.*, 2+2=5),[28] Congress first expanded the IRS's math error authority to address "clerical errors" (*e.g.*, inconsistent entries on the face of the return),[29] and then expanded it to address other circumstances such as where a taxpayer omits a required TIN or uses an SSN that does not match the one in the Social Security Administration's Numident database.[30]

Congress Carefully Limited Summary Assessment Procedures

Congress was concerned about substituting summary assessment procedures for deficiency procedures.[31] It generally reserved summary assessment procedures for simple situations where "not only is the error apparent from the face of the return, but the correct amount is determinable with a high degree of probability from the information that appears on the return."[32] Noting that authorizing summary assessment procedures when the taxpayer omitted a required schedule may arguably depart from this general approach, a committee report explained that "disputes as to the *adequacy* of the schedule that the taxpayer submits are to be dealt with under normal administrative procedures and not by use of extraordinary summary assessment procedure."[33] The IRS was not to use summary assessment procedures "where it is not clear which of the inconsistent entries is the correct one" or for "resolving an uncertainty against the taxpayer."[34]

If taxpayers do not understand the supposed error, they may have difficulty deciding whether to request an abatement (assuming they understand that requesting abatement is an option). They are also less likely to request abatement within the shorter 60-day period applicable to summary assessments. Accordingly,

28 H.R. Rep. No. 691, at 10-11 (1926).

29 Pub. L. No. 94-455, § 1206(b), 90 Stat. 1520, 1704 (1976) (defining "mathematical or clerical error" to include (1) errors in addition, subtraction, multiplication, or division shown on any return, (2) an incorrect use of any table provided by the IRS with respect to any return if such incorrect use is apparent from the existence of other information on the return, (3) an entry on a return of an item that is inconsistent with another entry of the same or another item on the return, (4) an omission of information which is required to be supplied on the return to substantiate an entry on the return, and (5) an entry on a return of a deduction or credit in amount which exceeds certain types of statutory limits). The IRS had interpreted "math errors" broadly, but courts had limited its use to arithmetic errors; thus the 1976 legislation formally expanded it to encompass "clerical" errors, while also "restricting" its use by the IRS. H.R. Rep. No. 94-658, at 289 (1976).

30 IRC § 6213(g)(2). A "mathematical or clerical error" currently includes 14 categories of errors (in subparagraphs A-N), including (a) an omission of a correct TIN required to be included on a tax return for certain tax credits, and (b) the inclusion of a TIN indicating that the individual's age disqualifies them from certain credits, as discussed above. *Id*.

31 *See* H.R. Rep. No. 94-658, at 289 (1976); S. Rep. No. 94-938(I), at 375 (1976); Joint Committee on Taxation (JCT), *General Explanation of the Tax Reform Act of 1976*, JCS 33-76, 372 (1976) (*Assessments in Case of Mathematical or Clerical Errors, Sec. 1206 of the Act and Sec. 6213 of the Code*). Although the IRS originally had the authority to assess EITC overpayments without providing taxpayers an opportunity for judicial review in a pre-payment forum (under former IRC § 6201(a)(4)), Congress specifically granted taxpayers this right in 1988. *See* Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100–647, § 1015(r), 102 Stat. 3342, 3572 (1988).

32 H.R. Rep. No. 94-658, at 292 (1976).

33 *Id*. at n.1 (emphasis added).

34 *Id*. at 291.

Congress also enacted IRC § 6213(b)(1), requiring that "[e]ach notice under this paragraph shall set forth the error alleged and an explanation thereof,"[35] and should "include questions designed to show whether the taxpayer indeed is entitled" to what they claimed on the return.[36]

REASONS FOR CHANGE

As the IRS Receives More Data and Fewer Resources, It May Be Tempted to Apply Summary Assessment Procedures to a Wider Range of Situations

As the IRS's resources have decreased, it has proposed that Congress expand its summary assessment authority as a seemingly cost-effective way to assess deficiencies and protect revenue.[37] This temptation will increase as the IRS receives more data that may be or appear to be inconsistent with a person's return. The IRS received about 2.1 billion information reporting documents in 2013 (including 47.5 million on paper), and projects a steady increase through 2022.[38] It will also begin receiving new types of information. Notably, the IRS will soon begin receiving information from health insurers and self-insured employers about people's health coverage;[39] credit card issuers recently started reporting the aggregate amount of reportable payments they process for businesses;[40] and brokerage firms generally must now report the cost bases (as well as gross proceeds) of stock, bond, and mutual fund sales.[41] It should make this data available to taxpayers during the filing season to help them in preparing accurate returns, and use it to inform them of seeming inconsistencies when they file or as soon afterward as possible. However, the increasing availability of tax-related data is likely to prompt the IRS to ask Congress to expand its authority to use math error procedures to assess additional tax when there appear to be inconsistencies between the data and a tax return.

Congress Should Consider Expanding the IRS's Summary Assessment Authority Only in Limited Situations

It is appropriate to expand the IRS's summary assessment authority to cover only one of the situations described in the Administration's correctable error proposal — where there can be no doubt that the taxpayer has claimed amounts in excess of a lifetime limitation based on information shown on the return.

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35 Pub. L. No. 94-455, § 1206(a), 90 Stat. 1520, 1703 (1976).

36 H.R. Rep. No. 94-658, at 291 (1976).

37 *See generally* 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*).

38 IRS Pub. 6961, *Calendar Year (CY) Projections of Information and Withholding Documents for the United States and IRS Campuses* (July 2014), Tables 2 and 3.

39 Notice 2013-45, 2013-31 I.R.B. 116; T.D. 9660, 2014-13 I.R.B. 842 (Mar. 10, 2014). Reporting entities are not subject to penalties for failure to comply with the IRC §§ 6055 and 6056 reporting requirements for coverage in 2014 (including the provisions requiring the furnishing of statements to covered individuals in 2015 with respect to 2014). *Id*. These information returns, which are submitted with new Form 1095-B, *Health Coverage*, are not reflected in the IRS's information return projections. IRS Pub. 6961, *Calendar Year (CY) Projections of Information and Withholding Documents for the United States and IRS Campuses* (July 2014), Table 2. For a discussion of related problems, see 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*, *supra*, and 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*, *supra*.

40 Pub. L. No. 110-289, Div. C, Title III, § 3091(a), 122 Stat. 2654, 2908 (2008) (codified at IRC § 6050W, applicable to returns for calendar years beginning after 2010). The IRS received about 10.3 million Forms 1099-K, *Merchant Card and Third Party Payments*, in 2013 and expects to receive about 11.6 million in CY 2022. IRS Pub. 6961, *Calendar Year (CY) Projections of Information and Withholding Documents for the United States and IRS Campuses* (July 2014), Table 2.

41 Energy Improvement and Extension Act of 2008, Pub. L. No. 110-343, Div. B, § 403(a)(1), 122 Stat. 3765, 3854 (2008) (codified at IRC § 6045(g) and phased in between 2011 and 2013).

For example, in cases where it is clear that a taxpayer has claimed an American Opportunity Tax Credit (AOTC) in excess of a statutory limit, then the summary assessment process may be appropriate. The AOTC is a partially refundable credit for qualified post-secondary education expenditures that is available only for the first four years of a student's post-secondary education.[42] Because the number of years claimed for each student is shown on the face of the return, allowing the IRS to use math error procedures to stop the improper payment of capped claims may be appropriate and cost effective, although probably not as cost effective as alerting the taxpayer to the problem at or before filing.[43]

Inappropriate Expansion of Summary Assessment Authority Could Unduly Burden Taxpayers While Eroding the Right to Judicial Review

Without adequate safeguards and congressional oversight, the other proposed expansions of summary assessment authority would erode the right to judicial review *before* paying an audit assessment, which is the cornerstone of due process in the U.S. tax system. The taxpayer bears the burden of asking for the right to petition the Tax Court within a 60-day period, rather than automatically receiving that right under normal IRS deficiency procedures.

It Can Be Difficult to Determine If a Particular Document Is Attached

The correctible error proposal could potentially allow the IRS to "correct" already-accurate returns that do not appear to include required documentation. However, it can be difficult to determine if a particular document is attached to a return, as illustrated by the FTHBC (discussed above).

Accurate Returns May Appear Inconsistent With Government Data

The correctible error proposal could potentially allow the IRS to "correct" already-accurate returns that do not match the information contained in government databases. There are a wide variety of reasons for why accurate returns may appear inconsistent with government data. As illustrated by the FCR database, third-party data may not be sufficiently accurate.

Moreover, applying data collected for nontax purposes to tax claims is akin to relying on the addresses shown in a telephone directory to deny the home mortgage interest deduction. Even if virtually all of the entries in a directory were accurate, they were compiled for a different purpose, do not disprove eligibility under the tax law, may not be current, and should not deprive a taxpayer of a due process right to present his or her own facts.

Of course, even data collected for tax purposes contains errors. By one estimate, 1.5 percent of information returns have invalid payee data.[44] If other information on these returns is inaccurate at the same rate, the IRS might burden about 31.5 million taxpayers with erroneous assessments (1.5 percent of the 2.1 billion information returns, noted above), if it could make a summary assessment based solely on

42 *See* IRC § 25A(i).

43 *See Improper Payments in the Administration of Refundable Tax Credits, Hearing Before the H. Subcomm. on Oversight, Comm. on Ways and Means* (May 25, 2011). Both the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) have recommended expanding math error authority to correct returns claiming the Hope Credit (now called the American Opportunity Tax Credit) in more years than allowed by law. *See* GAO, GAO-10-225, *IRS Met Many 2009 Goals, But Telephone Access Remained Low, and Taxpayer Service and Enforcement Could Be Improved* (Dec. 2009); TIGTA, Ref. No. 2009-30-141, *Improvements Are Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions* (Sept. 30, 2009).

44 TIGTA, Ref. No. 2011-30-019, *Targeted Compliance Efforts May Reduce the Number of Inaccurate Information Returns Submitted by Government Entities* 3-4 (Feb. 15, 2011).

inconsistencies between returns and information returns. Even the government sent out 800,000 incorrect information reporting documents (Forms 1099-A) in the 2015 filing season.[45]

Longstanding IRS matching programs further illustrate how third-party data are often unreliable when used as the sole basis to conclude that the taxpayer's return is wrong. The IRS's automated underreporter (AUR) process adjusts returns where there are mismatches between a tax return and data from third-party information returns, such as Forms W-2 and 1099. For tax years (TYs) 2009-2011, 24.9 percent of these mismatches did not result in an assessment.[46] Thirty-seven percent of the SNODs went unanswered, resulting in default assessments.[47] About 4.6 percent of all AUR assessments (and 16.3 percent of the dollars) were abated.[48] For taxpayers who specifically requested reconsideration of an AUR assessment in FY 2012, the IRS abated at least part of the assessment about 82.9 percent of the time (82.7 percent of the dollars).[49] Thus, even data from information returns is a weak basis on which to conclude that a taxpayer's return is wrong.[50]

Because Congress and the judiciary have recognized that third-party information returns can be unreliable and difficult for a taxpayer to disprove, the IRS is not always entitled to rely on its general presumption of correctness in court when its determination is based on them.[51] In the context of an exam, even the IRS recognizes the unreliability of third-party information and attempts to verify it with the taxpayer.[52] However, the IRS could potentially replace its AUR program with summary assessment procedures under the correctable error proposal, eroding a taxpayer's right to have a court review the determination.[53]

"Mismatches" Should Not Trigger an Adjustment If the IRS Can Explain Them

Not every return that contains a typo or similar error contains an understatement, as illustrated by the TAS study of math errors involving dependent TINs (described above). As that study showed, the IRS imposed a burden on taxpayers in a large percentage of math error cases, generating phone calls and letters it could not timely handle, rather than investing a few minutes of research at the front end. Further, for those who did not respond, the IRS improperly denied tax benefits even when it had the correct TINs in its files.

45 Notice 2015-30, 2015-17 I.R.B. 928; IRS, *Questions and Answers - Incorrect Forms 1095-A and the Premium Tax Credit* (July 6, 2015), *available at* https://www.irs.gov/Affordable-Care-Act/Individuals-and-Families/Questions-and-Answers-Incorrect-Forms-1095A-and-the-Premium-Tax-Credit; IRS SERP Alert 15A0147 (Apr. 6, 2015).

46 Individual Master File (June 11, 2015) (of the 16,242,759 TY 2009-2011 tax modules with mismatches that were assigned to AUR, 4,044,403 did not result in an assessment). In some cases this may have been because the taxpayer explained the reason for the mismatch before a deficiency was assessed, but in others it may have been because the IRS decided not to pursue the discrepancy.

47 IRS response to TAS information request (May 28, 2015). TYs 2009-2011 are the three most recent years for which the IRS has complete data. For these same years, 12 percent of the IRS's SNODs were returned to the IRS as undeliverable. *Id*.

48 IRS Compliance Data Warehouse (CDW), Enforcement Revenue Information System (ERIS) (Dec. 11, 2015) (AUR assessments in TYs 2009–2011).

49 IRS CDW, ERIS (Dec. 11, 2015) (reconsiderations in FY 2012).

50 According to TIGTA, more than two billion information returns were submitted to the IRS in TY 2007, of which almost 31.7 million had invalid payee data (1.5 percent). TIGTA, Ref. No. 2011-30-019, *Targeted Compliance Efforts May Reduce the Number of Inaccurate Information Returns Submitted by Government Entities* 3-4 (Feb. 15, 2011).

51 *See, e.g.*, *Portillo v. Comm'r*, 932 F.2d 1128 (5th Cir. 1991); IRC § 6201(d).

52 *See, e.g.*, IRM 4.10.3.2.1.4(2) (Mar. 1, 2003) ("Information about taxpayers collected from third parties will be verified to the extent practicable with the taxpayer before action is taken.").

53 For further discussion of the problems with this approach, see, *e.g.*, 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*); Real-Time Tax System Initiative Comments of Keith T. Fogg, Director, Villanova Law School Federal Tax Clinic (Dec. 8, 2011), *available at* http://www.irs.gov/pub/irs-utl/t._keith_fogg_aba_tax_section_and_low_income_tax_clinic.pdf.

"Mismatches" Between a Return and a Database That Reflects the Probability of an Error Should Not Trigger an Adjustment

As described above, the DDb combines unreliable FCR data with other information, which the IRS uses to estimate the probability that a taxpayer has improperly claimed a dependent. It would be a slippery slope to authorize the IRS to assess a tax using summary assessment procedures based on its estimate of the probability that a return contains an error. Under the correctable error proposal, however, Treasury Regulations could essentially define such estimates as "mismatches" that would trigger summary assessment authority. When taxpayers do not understand math error notices or the procedure for disputing the assessment, the resulting delay may cost them the opportunity to contest it in a prepayment forum, or even the opportunity to obtain benefits to which they are entitled.

EXPLANATION OF RECOMMENDATIONS

The National Taxpayer Advocate presents six broad recommendations that would help ensure the IRS uses math error procedures only in appropriate circumstances. First, the IRS would be permitted to use math error procedures only after reviewing and revising all of its math error notices to ensure they clearly describe what the IRS changed and why, and how to contest the change. For situations that the IRS can or will not clearly describe on a math error notice, it could use normal deficiency procedures.

Second, the IRS would be permitted to use math error procedures only when there is a mismatch between the return and unquestionably reliable data. For example, because the DDb filters combine unreliable data from various sources to create a more reliable estimate of the probability that a taxpayer's return is inaccurate, this proposal would not authorize the IRS to rely on such filters.

Third, the IRS would be permitted to use math error procedures only after it has researched all of the information in its possession that could help explain the apparent discrepancy so that it does not need to burden the taxpayer by requesting an explanation. For example, if a return contains an inaccurate dependent TIN, the IRS would review the taxpayer's prior year returns to determine if the error was a typo. If so, it could inform the taxpayer that it had corrected the typo, rather than burdening the taxpayer with an inaccurate tax assessment.

Fourth, the IRS would be permitted to use math error procedures only in situations where it does not have to analyze facts and circumstances or weigh the adequacy of information submitted by the taxpayer to determine if the return contains an error. For example, while the math error process could require the IRS to determine if the taxpayer included an attachment (*i.e.*, a yes/no determination), the proposal would not authorize its use on the basis that the documentation was insufficient (*i.e.*, a facts and circumstances inquiry).

Fifth, the IRS would be permitted to use math error procedures only if the annual abatement rate for a particular issue or type of inconsistency is below a specified threshold for those taxpayers who respond. The IRS would compute and report the abatement rate on an annual basis so that it could respond to changes in the accuracy of its assessments. It would exclude taxpayers who do not respond so as to avoid a bias toward applying math error procedures to populations that are less responsive to IRS notices (*e.g.*, because they are transient or are less likely to understand IRS correspondence).

Finally, the IRS would be permitted to use math error procedures for any new data or criteria only if, the Department of Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported to Congress on the reliability of the data or criteria for purposes of assessing tax using math

error procedures. The report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs to taxpayers (*e.g.*, time, paperwork, representation) and the IRS (*e.g.*, processing taxpayer calls and letters, requests for audit reconsideration, amended returns, appeals, and TAS intervention).

The GAO has proposed a similar study to evaluate third-party data reliability.[54] As noted above, Congress mandated a similar study before the effective date of the IRS's math error authority to address FCR data mismatches, a study that the IRS would not have undertaken without the mandate. These safeguards would help prevent the IRS from unnecessarily wasting resources and burdening taxpayers by making summary assessments based on conclusions that involve the exercise of judgment, information that is not sufficiently accurate, or estimates of the likelihood of an error. They would also be consistent with the taxpayers' *rights to quality service*, *to pay no more than the correct amount of tax, to privacy, to challenge the IRS's position and be heard,* and *to appeal an IRS decision in an independent forum.*

54 GAO, GAO-11-691T, *Enhanced Pre-Refund Compliance Checks Could Yield Significant Benefits* 9 (May 25, 2011) ("To ensure IRS continues to use MEA [math error authority] only in these limited circumstances [*i.e.*, where the error is "virtually certain"] if given broader authority, Congress could, for example, require IRS to submit a report to it or an entity it designates on a proposed new use of MEA. The report could include how such use would meet the standards or criteria outlined by Congress. The report could also describe IRS's or the National Taxpayer Advocate's assessment of any potential effect on taxpayer rights.").

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

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

PROBLEM

Taxpayers rely on Individual Retirement Accounts (IRAs) or defined contribution plans, such as 401(k) plans, or Thrift Savings Plans (TSP) for federal employees, to fund living and other expenses after retirement. Understanding the importance of U.S. taxpayers having sufficient retirement savings, Congress has encouraged retirement savings and formulated statutes to protect the rights of individuals to pensions.[2] Similarly, the IRS acknowledges the long-term importance of retirement assets to individuals' future welfare by regarding retirement levies as "special cases" that require additional scrutiny and managerial approval.[3]

Nevertheless, 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.[4] For instance, the determination of whether "flagrant behavior" has occurred is an important prerequisite for levying on a retirement account.[5] According to that guidance, if the IRS determines that a taxpayer has engaged in flagrant conduct, it may consider levying on a retirement account. The guidance also provides that if a taxpayer has not engaged in flagrant conduct, then the levy should not occur. Thus, the determination of flagrant behavior is critical in determining whether to levy on a retirement account.

However, 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. This could lead to inconsistent treatment of similarly situated taxpayers, which could erode taxpayers' confidence in a fair tax system and decrease voluntary compliance. More importantly, the IRS's approach undermines Congress' goal to have people able to afford basic living expenses while in retirement.

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 For example, the Employee Retirement Income Security Act of 1974 (ERISA) was enacted to provide protection for participants in pension and health plans in private industry. *See* Pub. L. No. 93–406, 88 Stat. 829 (1974).

3 IRM 5.11.6.2(3) (Sept. 26, 2014).

4 *See* IRM 5.11.6.2(4)-(7) (Sept. 26, 2014). For a more detailed discussion, see Most Serious Problem: *Levies on Assets in Retirement Accounts: Current IRS Guidance Regarding the Levy of Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy*, *supra*.

5 IRM 5.11.6.2(5) (Sept. 26, 2014).

EXAMPLE

A taxpayer is 57 years old and has worked at her current job for over ten years. For much of that time she has had five percent of her wages automatically contributed to her retirement account, which has been matched with an equal contribution by the employer. Prior to working at her current job, the taxpayer was self-employed. The taxpayer fell behind on her tax liabilities while she was self-employed and now owes over $50,000. As part of the routine collection process, a revenue officer (RO) assigned to her case has identified the retirement account as the taxpayer's only asset that can fully pay the liability. Using the current internal guidance, the RO determined that the taxpayer's continued retirement account contributions, while she has an outstanding tax liability, constitutes flagrant conduct. The RO also determined that, despite the taxpayer being 57 years old, she still has adequate time to save for retirement. In making that determination, the RO did not consider the taxpayer's basic living expenses at retirement, nor did he consider the taxpayer's life expectancy or the actual amount she would realistically be able to save from age 57 to retirement. As a result, the IRS levies the entire amount of the taxpayer's retirement account to fully satisfy her tax liability. The taxpayer is left without retirement savings less than a decade before she will retire.

RECOMMENDATION

To protect taxpayer rights and to further retirement security public policy, 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.[6]

PRESENT LAW

IRC § 6331 authorizes the IRS to levy on a taxpayer's property and rights to property. This power allows the IRS to levy on funds held in retirement accounts.[7] Generally, the levy on a retirement account will only reach the assets over which the taxpayer has a present withdrawal right (*i.e.*, a levy will not attach until the taxpayer has a present right to withdraw funds from the plan).[8] IRM guidance explains a "current levy can reach a taxpayer's vested present rights under a plan, but a levy does not accelerate payment and

6 A bill has been introduced in the House and Senate that recommends a stricter standard for defining flagrant conduct. The proposed definition includes: "(A) the filing of a fraudulent return by the taxpayer, or (B) that the taxpayer acted with the intent to evade or defeat any tax imposed by this title or the collection or payment thereof." Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 307 (2015). The proposed language also provides a statutory change by making retirement plans (including TSP accounts) exempt from levy unless "(A) the amount of tax (excluding interest and penalties) owed by the taxpayer exceeds $10,000, (B) the Secretary determines that the taxpayer has committed a flagrant act, and (C) the Secretary determines that such levy will not create an economic hardship due to the financial condition of the taxpayer (as described in [IRC] section 6343(a)(1)(D))." Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. §307 (2015). For more information on the bill, see Senator Ben Cardin, *Cardin and Becerra Introduce Plan to Protect Taxpayers' Rights*, *available at* http://www.cardin.senate.gov/newsroom/press/release/cardin-and-becerra-introduce-plan-to-protect-taxpayers-rights. The National Taxpayer Advocate believes this is another way to address the concerns involving retirement account levies.

7 For information on what constitutes a retirement plan, see IRC § 4974(c).

8 IRM 5.11.6.2(8) (Sept. 26, 2014).

is only enforceable when the taxpayer is eligible to receive benefits."[9] If a taxpayer has a defined benefit plan and has no present right to withdraw the account balance, the IRS will have no corpus (the main part of the retirement plan) to levy upon at the present time. Rather; the IRS can only levy the monthly distributions or the corpus of the account once a taxpayer reaches retirement age, subject to allowances for reasonable basic living expenses, which are calculated based on circumstances at that time. However, recent changes in the TSP regulations allow a levy on a TSP account to reach up to the entire vested account balance.[10]

The IRS has established three steps that must be taken before it can issue a notice of levy on a taxpayer's retirement account:

- Determine what property (retirement assets and non-retirement assets) is available to collect the liability;
- Determine whether the taxpayer's conduct has been flagrant; and
- Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[11]

REASONS FOR CHANGE

It is important to make sure that the determination to levy on a retirement account is correct.[12] Once removed, funds levied from a retirement account cannot be returned to that retirement account, even in the event of a wrongful levy.[13] Second, when a distribution occurs as the result of levy action, the taxpayer will experience tax consequences. Pursuant to IRC § 408(d), generally, the entire amount paid from a retirement account or any distribution, is considered gross income and is subject to taxation. In the instance of a levy on a retirement account, the payor would be required to withhold ten percent.[14] However, this amount of withholding is not guaranteed to be sufficient to cover the federal tax liability created by the distribution, and the taxpayer may be liable for a state income tax as well.

Even with the gravity of a retirement levy and the need for a correct decision, current internal guidance does not ensure that a taxpayer's unique facts and circumstances will be considered prior to levy of his or her retirement account. For instance, there is no on-point definition of flagrancy, which is a prerequisite

9 IRM 5.11.6.2(8) (Sept. 26, 2014). For instance, a taxpayer is fully vested in his retirement plan account balance of $10,000, but he is not yet entitled to a withdrawal. In this instance, a levy may attach to the taxpayer's present right to the $10,000, but no money can be collected until the taxpayer has a right to withdraw those funds. Assuming the balance has grown to $30,000 by the time the taxpayer is eligible to withdraw the funds, the IRS will only be able to collect $10,000 because this was the taxpayer's present right at the time of the levy.

10 5 U.S.C. § 8437(e)(3), 5 C.F.R. § 1653.35, and IRM 5.11.6.2.1, *Thrift Savings Plan* (July 17, 2015).

11 IRM 5.11.6.2(4)-(7) (Sept. 26, 2014).

12 See Most Serious Problem: *Levies on Assets in Retirement Accounts: Current IRS Guidance Regarding the Levy of Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy*, *supra*.

13 The National Taxpayer Advocate recommended legislative changes to IRC § 401 (for Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans), IRC § 408 (for IRAs and SEP-IRAs), and IRC § 408A (for Roth IRAs) to authorize the reinstatement of funds to retirement accounts and other pension plans where the IRS levied upon the plans in error or in flagrant disregard of established IRS rules, procedures, or regulations and the funds were returned under IRC § 6343(d). National Taxpayer Advocate 2001 Annual Report to Congress 202-9. 5 C.F.R. § 1653.36(g) states that distributions made to satisfy an IRS levy may not be returned to a participant's TSP account.

14 IRC § 3405(b)(1). The payor generally is responsible for making this withholding, but the plan administrator may be liable in the case of certain plans. IRC § 3405(d)(1).

to making the levy determination. Instead, IRS employees receive their guidance in this area through various examples. Two particularly troublesome examples include:

- Taxpayers who continue to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed; or
- Taxpayers who voluntarily contributed to retirement accounts during the time period the taxpayer knew unpaid taxes were accruing.[15]

The examples described above are overly broad in terms of discouraging retirement savings for *any* taxpayer with an outstanding liability. The guidance also goes against strong public policy that encourages saving for retirement.[16] By statute, federal employees, without their consent, are automatically enrolled to have a certain percentage (typically three percent) of their salary contributed to the TSP.[17] This is done to encourage saving for retirement and to take advantage of employer matching; federal employees must take an affirmative step to stop these automatic contributions.[18] Other employer plans adopt a similar "opt-out" approach to automatically enroll employees.[19]

Another example of flagrant conduct includes taxpayers who have demonstrated a "pattern of uncooperative or unresponsive behavior," which includes, "failing to meet established deadlines, failing to attend scheduled appointments, failing to respond to revenue officer attempts to contact."[20] This guidance relies on a subjective determination by an IRS employee. For instance, one employee may determine that if a taxpayer is 30 days late in submitting documentation, then the taxpayer has been uncooperative, whereas another employee may consider a taxpayer uncooperative after 60 days. Without clear guidance, the IRS employee's determination is subjective and susceptible to personal judgment.

The IRS could adopt a definition of "flagrant" similar to the definition found in Treasury regulation § 1.507-1(c)(2) related to excise taxes on exempt organizations, which reads:

> a willful and flagrant act (or failure to act) is one which is voluntarily, consciously, and knowingly committed in violation of any provision of chapter 42 (other than sections 4940 or 4948(a)) and which appears to a reasonable man to be a gross violation of any such provision.

This definition contains the necessary elements of willful and voluntary conduct as well as gross violation. This definition balances the government's interest in the efficient collection action with the government's interest in retirement security for individuals and protection of taxpayer rights.

Additionally, while the IRM does mention extenuating circumstances may exist to mitigate a taxpayer's behavior, it does not contain any examples of such extenuating circumstances.[21] Nor does the IRM require the IRS employee to identify mitigating circumstances, which could include IRS delays, IRS failures

15 IRM 5.11.6.2(6) (Sept. 26, 2014).

16 Congress has focused its efforts on improving retirement savings for Americans. Senator Orrin Hatch recalled in 2014 that, "[t]he retirement policies we have pursued have always been about helping Americans help themselves save more of their hard-earned money, not less." *Retirement Savings 2.0: Updating Savings Policy for the Modern Economy, Hearing Before the Committee on Finance*, 113th Cong. (2014) (statement of Orrin Hatch, ranking member, Committee on Finance).

17 5 U.S.C. § 8432(b)(2)(A). *See also* Thrift Savings Plan, *Summary of the Thrift Saving Plan* 2, *available at* https://www.tsp.gov/PDF/formspubs/tspbk08.pdf (last visited June 30, 2015).

18 *Id.*

19 Automatic enrollment in 401(k) and similar plans was one of the most highly touted changes in the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006).

20 IRM 5.11.6.2(6) (Sept. 26, 2014).

21 IRM 5.11.6.2(5) (Sept. 26, 2014).

to meet appointments or take promised actions, or IRS failures to follow its own published procedures.[22] Again, this internal guidance is susceptible to subjective interpretation by an individual IRS employee.

Without an on-point definition for flagrancy and an inquiry into whether the taxpayer voluntarily committed a gross violation, the IRS employee could find flagrancy where there was an unconscious and involuntary, or unknowing violation. This means the IRS could be reducing a taxpayer to poverty in retirement because of an unconscious or unknowing act.

The last step in determining if a levy on a retirement account is appropriate is to decide if the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[23] To conduct this analysis, employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to establish necessary living expenses and the life expectancy tables in Publication 590-A, *Individual Retirement Arrangements* (IRAs), to estimate how much can be withdrawn annually to deplete the retirement account in the taxpayer's remaining life.[24]

While the guidance refers the employee to IRM 5.15 to determine necessary living expenses, there is no requirement to calculate the taxpayer's projected retirement income when he or she retires. Additionally, there is no requirement to document the actual calculations, making it impossible to verify that a consistent method is used in all retirement levy cases. The financial analysis handbook does not take into account cost of living increases or adjustments for increased expenses due to advanced age either, such as rising health care or hospice costs. Finally, the guidance lacks a safeguard that, if the IRS determines a 50-year-old taxpayer does not currently rely on the retirement account (and will not rely on it in the near future), the taxpayer has sufficient opportunity to rebuild the retirement account back up to a level that provides for a stable retirement.[25]

EXPLANATION OF RECOMMENDATION

This legislative change will balance the need to efficiently collect taxes with the strong and longstanding public policy supporting financially secure retirements. A taxpayer cannot adequately challenge the decision to levy without being provided a detailed analysis of the basis for levy, a situation which impacts the taxpayer's *right to challenge the IRS's position and be heard*. Similarly, without clear guidance, taxpayers do not know what they need to do to comply with tax laws, so they can avoid a determination of "flagrant behavior," which diminishes the *right to be informed*.

22 When an IRS employee has not followed published administrative guidance (including the IRM), the National Taxpayer Advocate may construe the factors in a light most favorable to the taxpayer when deciding to issue a Taxpayer Assistance Order. IRC § 7811(a)(3).

23 IRM 5.11.6.2(7) (Sept. 26, 2014). Employees are instructed not to levy on the retirement account if it is determined that the taxpayer depends on the money in the retirement account (or will in the near future).

24 *Id*. When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

25 There are tools publicly available to help taxpayers estimate their retirement earnings. The IRS could use such tools to compute an estimate of benefits. For instance, the Social Security Administration (SSA) provides an online tool to estimate Social Security retirement benefits. *See* SSA, *Retirement Estimator*, *available at* https://www.ssa.gov/retire/estimator.html. The TSP website offers an online calculator to figure out how a TSP contribution will affect account savings over time. *See* TSP, *Paycheck Estimator*, *available at* https://www.tsp.gov/PlanningTools/Calculators/paycheckEstimator.html.

The proposed legislative change would provide a clear definition of flagrancy which would be consistent with the interpretation provided by the Tax Court and the current IRS regulations in exempt organizations' context.[26]

Finally, the proposed legislative change would require the IRS to issue formal guidance regarding a full financial analysis of the taxpayer's projected income and basic living expenses at retirement, prior to allowing a levy on a retirement account based on the taxpayer's ability to meet necessary living expenses upon retirement.

Another acceptable approach to address the deficiencies associated with retirement account levies is presented in the recently proposed Taxpayer Rights Act of 2015. This bill proposes that retirement plans (including TSP accounts) should be exempt from levy unless "(A) the amount of tax (excluding interest and penalties) owed by the taxpayer exceeds $10,000, (B) the Secretary determines that the taxpayer has committed a flagrant act, and (C) the Secretary determines that such levy will not create an economic hardship due to the financial condition of the taxpayer (as described in [IRC] section 6343(a)(1)(D))."[27] The bill also proposes a definition for flagrant act that includes, "(A) the filing of a fraudulent return by the taxpayer, or (B) that the taxpayer acted with the intent to evade or defeat any tax imposed by this title or the collection or payment thereof."[28]

26 *See* Treas. Reg. § 1.507-1(c)(2); *Thorne v. Comm'r*, 99 T.C. 67, 108-109 (1992). In particular, the court found that the trustee engaged in "willful conduct" by knowing that certain procedures should be followed but not requiring them to be followed. Also, the court found that the trustee did not act reasonably by relying on oral assurances of his tax advisor after he received a notice of deficiency. Furthermore, making grants to himself and trustees' family members for their own travel to conferences was seen as a gross violation.

27 Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 307 (2015).

28 *Id*.

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

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

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.[2] For many years, the operation of this regime closely paralleled the approach taken by the IRS with respect to domestic withholding under IRC § 31 in that there were no restrictions limiting credits or refunds to the amount of withheld tax actually paid over to the IRS.[3] 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 has become increasingly concerned about fraudulent activity on the part of taxpayers and withholding agents.[4] Such is the case, even though approximately 85 percent of Chapter 3 and Chapter 4 withholding agents are domestic and therefore can be reached by the IRS for tax enforcement purposes.[5]

While IRS fears may have some foundation, the nature and extent of the potential fraudulent activities have not been established by the IRS through any comprehensive, statistically valid evidence.[6] 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. This action is not only costly for taxpayers, but for the IRS which estimates that an extension of the freezes through early 2016 will result in an interest expense of approximately $4.4 million.[7] As of August 31, 2015, over 50,000 refund claims aggregating to well in

1 *See* Taxpayer Bill of Rights *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 *See* Treas. Reg. §§ 1.1462-1 and §1.1464-1.

3 For a discussion of prior IRS practice in the processing of Chapter 3 refund claims, *see* Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent Out of the United States*, 6 (Sept. 2010).

4 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat 71 (2010); Notice 2015-10, 2015-20 I.R.B. 965.

5 Large Business and International before (LB&I) response to TAS information request (Sept. 9, 2015). This percentage is developed from data provided by the IRS with respect to fiscal year ending (FYE) 2012 and FYE 2013, which are the only years for which it furnished this information.

6 LB&I response to TAS information request (Sept. 9, 2015). After analyzing the issue with respect to the 2008 tax year (TY), TIGTA found no statistically significant indicia of fraud relating to IRS processing of refund claims by non-resident aliens. A judgmental sample of TY 2007 and TY 2008 returns, however, revealed significant control weaknesses in the processing of refunds claimed on Forms 1040NR that could be exploited and therefore should be remedied. TIGTA, Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent Out of the United States* 2 (Sept. 2010).

7 IRS presentation: *Foreign Account Tax Compliance Act, Large Business & International (LB&I) Withholding & Refunds (W&R) Discussion*, slide 4 (Oct. 2015).

excess of $100,000,000 have been frozen by the IRS.[8] The vast majority of these taxpayers filing refund claims actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population.[9] However, the IRS has indefinitely retained amounts owing to this substantial group of taxpayers while it proves the compliant majority innocent in order to protect the tax system from potential exploitation by the noncompliant few.[10] Moreover, the IRS has proposed issuing Chapter 3 and Chapter 4 regulations providing that, in general, even taxpayers who were subjected to proper withholding and who possess complete documentation of that withholding will nevertheless be fully or partially denied a refund of the withheld amounts unless the withholding agent has correctly remitted to the IRS the full amount of withholding for all taxpayers.[11] With that step, the IRS would largely complete the transformation of its prior administrative practice of treating domestic and international credit and refund claims similarly, to a new international enforcement regime under which the burdens and risks are disproportionately shifted to largely compliant taxpayers.

EXAMPLE

Taxpayer is a retired non-resident alien individual whose only U.S. source income during the year is dividend income from U.S. stocks. The dividend income is subject to U.S. tax, but in an amount less than what was withheld by the withholding agent. The withheld amount is remitted by the withholding agent to the IRS and is properly reported on the Form 1042-S issued to Taxpayer. Although Taxpayer files an early Form 1040NR seeking a refund of the overwithholding, several months elapse with no response from the IRS. Taxpayer, who relies on the overwithheld dividends as retirement income, contacts the IRS regarding the status of the refund and is forced to incur toll charges while waiting on hold for a lengthy period. When the call is finally answered, the IRS customer service representative says only that the IRS will need additional time to process the return and that Taxpayer should allow up to one year from the date the Form 1040NR was due.[12] The IRS states, "We apologize for the inconvenience," as Taxpayer wonders how to pay for short-term living expenses.[13] Where the refund is concerned, Taxpayer's only options are to hope that the review will occur more quickly than predicted, to contact the Taxpayer Advocate Service for assistance in expediting processing of the Form 1040NR, or, eventually, to file suit in a federal district court.

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8 IRS, Compliance Data Warehouse, IRTF Entity and IMF Trans History tables (Oct. 28, 2015); IRS presentation: *Foreign Account Tax Compliance Act, Large Business & International (LB&I) Withholding & Refunds (W&R) Discussion*, slide 9 (Oct. 2015).

9 TAS makes this assertion because our analysis found that individual taxpayers filing Form 1040NR refund claims have a lower percentage of high-scoring Discriminant Index Function (DIF) returns in comparison to filers overall. Data drawn Nov. 10, 2015 for TY 2014 from IRS Compliance Data Warehouse, IRTF Entity table, and IMF Transaction History tables. See particularly Total Positive Income (TPI) Class 72, which encompassed most taxpayers in this group. High-scoring DIF returns were defined as those with a DIF value that exceeded 80 percent of DIF scores in the general population for a particular TPI class. We calculated a cutoff point for DIF scores at the 80th percentile for each TPI class for TY 2014, and calculated the percentage of Form 1040NR refund filers in each TPI class that exceeded the DIF cutoff point. Overall, only approximately two percent of Form 1040NR refund filers exceeded their respective DIF cutoff points, compared to 20 percent for individual filers in the general population (especially TPI Class 72). Accordingly, Form 1040NR refund filers showed a lower percentage of "high-scoring" DIF returns, and thus more compliant behavior, than the overall population. We did, however, identify certain small groups of taxpayers within the overall group who appear to have considerable compliance issues (*see* TPI Classes 80 and 81). LB&I notes that the above-discussed "[s]coring methodologies and the filters used are not conclusive in determining if 1040NR filers are more compliant than the overall taxpayer population." LB&I response to TAS informal fact check (Dec. 11, 2015). This methodology, however, is the approach TAS typically employs to evaluate the relative reporting accuracy of two distinct groups.

10 *See* IRC § 6611(e)(4), under which the IRS may hold a claim without paying interest for up to 180 days from the later of the due date of the return or when the return is filed. The IRS may issue regulations providing some exceptions that could narrow the scope and impact of these freezes. Notice 2015-10, 2015-20 I.R.B. 965.

11 Notice 2015-10, 2015-20 I.R.B. 965.

12 IRS, SERP Alert 15A0416, *Form 1040NR Frozen Refund Extension* (Sept. 11, 2015).

13 *Id*.

Although Taxpayer's situation is unfortunate and unjustifiable, it actually could be worse. If the requisite Form 1042-S was not properly issued by the withholding agent, Taxpayer's right to receive the refund could be lost.[14] Likewise, even though amounts were correctly withheld from payments made to Taxpayer, if the withholding agent did not remit any deposits to the IRS with respect to those amounts, Taxpayer, although not at fault, would not be entitled to a refund.[15]

RECOMMENDATION

To protect taxpayer rights, the National Taxpayer Advocate recommends that Congress amend IRC §§ 33 and 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.

PRESENT LAW

Chapter 3 generally requires withholding agents to collect the substantive tax liability of non-resident aliens imposed under IRC §§ 871(a), 881(a), and 4948 by withholding on certain payments of U.S. source fixed or determinable annual or periodical income.[16] Likewise, Chapter 4 directs withholding agents to withhold tax on certain payments to foreign financial institutions (FFIs) that are covered nonparticipating FFIs and nonfinancial foreign entities that do not provide information regarding their substantial U.S. owners.[17] Chapter 4 also generally requires participating FFIs to withhold tax on certain payments to accounts of recalcitrant account holders and payees that are nonparticipating FFIs.[18]

Amounts withheld by withholding agents under Chapter 3 and Chapter 4 must be deposited with the IRS.[19] If, for any calendar year, the withholding agent fails to remit the proper amount of withheld taxes, it must pay the shortfall out of its own funds and is also subject to the payment of penalties and interest.[20] For each calendar year, withholding agents must file a Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, with the IRS showing the aggregate amount of income they withheld under Chapter 3 and Chapter 4 and the aggregate withholdings they remitted to the government.[21] Additionally, withholding agents issue Forms 1042-S to each taxpayer from which amounts have been withheld and file the Forms 1042-S with the IRS.[22] In order to claim a credit or refund of the amounts withheld, taxpayers must attach the Form 1042-S to their annual tax return.[23]

IRC § 33 allows non-resident aliens to claim a credit or refund of taxes withheld at source under Chapter 3. In turn, Chapter 4 provides that FATCA-related credits or refunds will be made available under the rules governing Chapter 3.[24] Specifically, the beneficial owner of the income may claim a credit of

14 Treas. Reg. § 301.6402-3T(e); IRM 21.8.1.11.14.1, *Claims for Tax Withheld at Source* (Oct. 1, 2015).

15 IRM 21.8.1.11.14.1, *Claims for Tax Withheld at Source* (Oct. 1, 2015).

16 IRC § 1441.

17 IRC §§ 1471(a), 1473(1). IRC § 1471(d)(1)(B) excepts from the reporting and withholding requirements those accounts that are held by individuals at the same FFI and have an aggregate value of $50,000 or less.

18 IRC § 1471(b)(1)(D).

19 IRC § 6302; Treas. Regs. §§ 1.1461-1(a), 1.1474-1(b), and 1.6302-2.

20 Treas. Reg. § 1.1461-1. *See also* IRC §§ 6601, 6651(a)(2), and 6656.

21 Treas. Reg. § 1.1461-1T(b)(1).

22 Treas. Reg. § 1.1461-1T(c).

23 Treas. Reg. § 301.6402-3T(e).

24 IRC § 1474(b)(1).

the amount of tax actually withheld under Chapter 3 or Chapter 4 against the total income tax computed on the beneficial owner's return.[25]

For cases of overwithholding, the Chapter 3 and Chapter 4 regulations can be read as generally providing a credit or refund of an overpayment of tax that has actually been withheld at source.[26] According to the IRS, however, "Under a special rule in section 6401(b)(2), the credit under section 33 is treated as a refundable credit only in the case of a beneficial owner who is a non-resident alien and who has made an election to be treated as a U.S. resident under section 6013(g) or (h)."[27] Barring such an election, the IRS's position now is that, even if withholding at source actually takes place, the overpayment required to support a refund only occurs if the withheld amounts are remitted by the withholding agent to the IRS.[28]

Based on this analysis, the IRS has initiated the practice of matching taxpayer requests for Chapter 3 or Chapter 4 credits or refunds with the information filed by withholding agents before allowing the requested claims.[29] To the extent that the claim for refund, which must be evidenced by a Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding,* cannot be matched with at least some deposit from the withholding agent, no credit or refund will be allowed.[30] Nevertheless, the IRS has not yet developed the technology necessary for automatic matching, a shortcoming warned against by the National Taxpayer Advocate in the 2013 Annual Report to Congress.[31]

As a result of this technological deficiency, the IRS originally imposed an across the board 168-day freeze on most Chapter 3 and Chapter 4 refund claims to allow for manual review.[32] The freeze has now been extended for up to one year from the date that any unreviewed and unverified returns were due or filed, whichever is later.[33] This one-year freeze period could be further expanded by the IRS as it attempts to implement automated matching systems for 2014, 2015, and beyond.

By contrast, the IRS has adopted the opposite approach with respect to credits and refunds of withheld employment taxes under IRC § 31, which is worded similarly to IRC § 33.[34] In the case of this domestic withholding, the IRS allows a credit or refund to taxpayers, even if the employer fails to make the actual deposit with the IRS. The regulations under IRC § 31 expressly provide, "if the tax has actually been withheld at the source, credit or refund shall be made to the recipient of the income even though such tax has not been paid over to the Government by the employer."[35]

Where Chapter 3 and Chapter 4 are concerned, however, the IRS has announced its intention to propose regulations that would allow full credits or refunds only after a taxpayer files the requisite Form 1042-S

25 IRC §§ 1462 and1474(b)(1); Treas. Reg. §§ 1.1462-1(a) and 1.1474-3(a).

26 Treas. Reg. §§ 1.1464-1(a) and 1.1474-5(a)(1).

27 Notice 2015-10, 3, 2015-20 I.R.B. 965.

28 *Id*.

29 IRM 21.8.1.11.14.1, *Claims for Tax Withheld at Source* (Oct. 1, 2015).

30 *Id*.

31 National Taxpayer Advocate 2013 Annual Report to Congress 244.

32 IRM 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (TC 810–3 -E Freeze) (May 1, 2015); IRS, SERP Alert 15A0188, *FATCA-Programming Beginning in January 2015 Affecting Certain Forms 1040NR (TC 810-3 -E Freeze* (Mar. 23, 2015).

33 IRS, SERP Alert 15A0416, *Form 1040NR Frozen Refund Extension* (Sept. 11, 2015); IRS, SERP Alert 15A0417, *Form 1120-F Frozen Refund Extension* (Sept. 11, 2015).

34 *See* IRC § 31.

35 Treas. Reg. §1.31-1(a).

if the IRS can confirm that the withholding agent remitted the full amount of the aggregate liabilities for which the withholding agent is responsible.[36] In the event that a withholding agent has only partially satisfied its deposit requirements with the IRS, the regulations will also provide for a *pro rata* allocation of the amount deposited among taxpayers seeking to claim credits or refunds for the withholding in question.[37] Some exceptions may be developed for certain scenarios, such as in cases where the under deposit of tax is *de minimis*, or in cases where the withholding agent in question has a demonstrated history of compliance with its deposit requirements.[38] None of these proposed exceptions, however, addresses circumstances where proper amounts were actually withheld from a specific taxpayer's account.

REASONS FOR CHANGE

The IRS has transformed Chapter 3 and Chapter 4 tax administration into a system that assumes noncompliance and is dedicated disproportionately to denying unwarranted benefits to the malfeasant few at the cost of the compliant majority who deserve their credits and refunds. Although the IRS may be reacting to control weaknesses in its non-resident alien refund process identified by TIGTA, the IRS has neither demonstrated that this category of taxpayers is comparatively noncompliant, nor that widespread fraud is actually occurring.[39] Nevertheless, most taxpayers seeking refunds of amounts withheld under Chapter 3 or Chapter 4 will have their refunds frozen for up to one year, if not longer, while the IRS attempts to match applicable documentation and satisfy itself that fraud has not occurred.[40] Moreover, no guarantee exists that this one-year period will not be further extended by the IRS as it attempts to implement automated matching systems for 2014, 2015, and beyond. Thus thousands of compliant taxpayers will experience indeterminate delays in receiving their legitimately claimed refunds, while the IRS tries to marshal its internal resources and detect a relatively few bad actors.

At the same time, the IRS is considering regulations that would allow taxpayers full refunds only to the extent that their withholding agent has fully remitted to the IRS all withholding liabilities for all taxpayers. As a result, a taxpayer could conceivably end up waiting a year or more only to find out that even though the taxpayer's withholding was properly collected and remitted to the IRS by the withholding agent, such was not the case with all other funds collected by the withholding agent, and therefore the taxpayer is only entitled to a proportional amount of the long-delayed refund. By contrast, the IRS currently accepts creditor-risk in the case of domestic withholding, such as on employment taxes, and taxpayers need only show that the withholding actually occurred to be entitled to a credit or refund from the IRS.[41]

The IRS argues that the shift in enforcement burden now proposed with respect to international withholding is necessary as a means of preventing fraud. Nevertheless, it has not produced any systematic and rigorous analysis documenting the nature and scope of this risk. No comprehensive statistically valid

36 Notice 2015-10, III.A., 2015-20, I.R.B. 965.

37 *Id*.

38 *Id*.

39 TIGTA, Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent Out of the United States*, 6 (Sept. 2010); LB&I response to TAS information request (Sept. 9, 2015).

40 IRM 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR (TC 810–3 -E Freeze)* (May 1, 2015). *See also* IRS, SERP Alert 15A0416, *Form 1040NR Frozen Refund Extension* (Sept. 11, 2015); IRS, SERP Alert 15A0417, *Form 1120-F Frozen Refund Extension* (Sept. 11, 2015). The IRS informed taxpayers that those who requested a refund of tax withheld on a Form 1042-S by filing a Form 1040NR will have to wait up to six months from the original due date of the 1040NR return or the date the 1040NR is filed, whichever is later, to receive any refund due. IRS, *What to Expect for Refunds in 2015*, *available at* http://www.irs.gov/Refunds/What-to-Expect-for-Refunds-This-Year (last visited on Apr. 1, 2015).

41 IRC § 31(a); Treas. Reg. § 1.31-1(a).

evidence has yet been produced to support IRS assertions that significant tax noncompliance is occurring, or may begin occurring, in the context of international withholding. The vast majority of taxpayers filing Forms 1040NR, *U.S. Non-resident Alien Income Tax Return*, seeking refund claims actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population.[42] Although concerns regarding potential fraud should be taken seriously, open-ended retention of taxpayer funds, reallocation of creditor burdens to taxpayers, and fundamental shifts in tax policy should not be based on unsubstantiated conjecture. Where evidence of fraud exists, the IRS should develop procedures that are narrowly tailored to address the risk of fraud, and not impose undue burden on taxpayers who are complying with the law.

The IRS has asserted that once improperly refunded amounts have left U.S. jurisdiction and gone abroad, they are virtually impossible for the IRS to recover. While this statement may be true, the IRS does not generally face this risk in the context of potential wrongdoing by Chapter 3 and Chapter 4 withholding agents. Indeed, according to the IRS, approximately 85 percent of these withholding agents are domestic and, therefore, can be reached by the IRS for tax enforcement purposes.[43]

Thus, withholding agents, even those active in the international context, are primarily domestic and, to the extent they engage in noncompliant behavior, can be compelled by the IRS to remit the withholding payments they have collected, even where no-nresident taxpayers are involved.[44] The IRS has far more effective tools and comprehensive resources at its disposal for this type of enforcement than the individual taxpayers to whom the IRS would now allocate this burden.

Further, according to the Information Reporting Program Advisory Committee (IRPAC), there are many non-fraudulent reasons for a deposit shortfall and most withholding agents have a proven track record in making accurate and timely deposits.[45] For example, the IRS might have unilaterally debited a withholding agent's Chapter 3 tax deposit account in order to settle a tax liability associated with another account of that agent.[46] Likewise, the withholding agent might have made a coding mistake when making its deposit with the IRS.[47] IRPAC concluded that the *pro rata* approach contemplated by the IRS confuses the legitimate problem of fraudulent refund claims with collection of shortfalls in withholding deposits.[48]

IRS concerns regarding the possibility of fraud may well be legitimate. Nevertheless, the sweeping solutions implemented by the IRS do not properly balance the operations of 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*. In so doing, the IRS unnecessarily burdens taxpayers and unintentionally may well be discouraging investment in the United States and harming global commerce.

Accordingly, taxpayers should retain the right to receive their Chapter 3 or Chapter 4 credits or refunds in a timely fashion, if they can demonstrate, to the satisfaction of the IRS, that the withholding actually occurred. These rights should parallel those existing with respect to domestic withholding. In order to be entitled to a Chapter 3 or Chapter 4 credit or refund, a taxpayer should be required to provide only

42 See discussion regarding DIF scores of Form 1040NR refund filers, *supra*.

43 LB&I response to TAS information request (Sept. 9, 2015). This percentage is developed from data provided by the IRS with respect to FYE 2012 and FYE 2013, which are the only years for which it furnished this information.

44 Treas. Reg. § 1.1461-1T(c). *See also* IRC §§ 6601, 6651(a)(2), and 6656.

45 IRPAC Public Report, International Reporting and Withholding Subgroup Report 65, 69 (Oct. 28, 2015).

46 *Id*.

47 *Id*.

48 *Id*.

a matching Form 1042-S from a withholding agent, or other persuasive evidence that withholding has taken place, unless the IRS has detected some affirmative indicia of fraudulent activity. Further, the burden of pursuing noncompliant withholding agents should not be borne by taxpayers with legitimate refund claims. Rather, as in the case of domestic withholding, the IRS should mobilize its widespread enforcement powers and seek to collect what is properly due and owing from these malfeasant withholding agents.

EXPLANATION OF RECOMMENDATION

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. 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.

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

TAXPAYER RIGHTS IMPACTED[1]

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

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.[2] Many U.S taxpayers, particularly those living abroad, have incurred increased compliance burdens and costs as a result of FATCA reporting obligations on Form 8938, *Statement of Specified Foreign Financial Assets*, that significantly overlap with the Financial Crimes Enforcement Network (FinCEN) Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), filing requirements.[3] These burdens 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.[4]

Congress has given the IRS broad authority to issue regulations and guidance for the purpose of eliminating duplicative reporting requirements.[5] 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.[6] However, it repeatedly declined to adopt the National Taxpayer Advocate's recommendations[7] to forego duplicative FATCA reporting

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010) (adding Internal Revenue Code (IRC) §§ 1471-1474; 6038D). *See also Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010).

3 *See* IRS Form 8938, *Statement of Specified Foreign Financial Assets* (2015) and FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (Oct. 2013). *See also* IRS, Comparison of Form 8938 and FBAR Requirements, *available at* https://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements; National Taxpayer Advocate 2013 Annual Report to Congress 235.

4 *See, e.g.*, National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 48-52; National Taxpayer Advocate 2013 Annual Report to Congress 238-48. Under FATCA, to avoid being withheld upon a 30 percent withholding tax on certain U.S.-source payments made to them, FFIs may register with the IRS and agree to report certain information about their U.S. accounts, including accounts of certain foreign entities with substantial U.S. owners. IRC §§ 1471-1474.

5 *See, e.g.*, IRC §§ 6038D(h)(1); 1471(d)(1)(C)(ii).

6 *See* Treas. Reg. § 1.6038D-7(a) and (c). For examples of information returns, see, *e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891.

7 *See* National Taxpayer Advocate 2014 Annual Report to Congress 343-45; National Taxpayer Advocate 2013 Annual Report to Congress 228-37; National Taxpayer Advocate 2013 Annual Report to Congress 238-48; National Taxpayer Advocate 2012 Annual Report to Congress 134-53; TAS Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 15, 2015) and (Apr. 24, 2014). *See also National Taxpayer Advocate Seeks End to Duplicative FATCA Reporting*, 2015 TNT 71-16 (Apr. 14, 2015).

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.[8]

EXAMPLE

Madeleine and Jacque Legrand are citizens and *bona fide* residents of France. Madeleine is also an "accidental" U.S. citizen. She was born in New York City where her parents worked as foreign researchers at a U.S. university on a J-1 visa. Madeleine left the United States for France with her parents at the age of three. As an adult, she visited the United States for brief periods on several occasions prior to 2006, but has never worked in the United States. Over 20 years of employment, Madeleine and her husband have saved about 800,000 Euros for retirement that are invested in mutual funds and certificates of deposit. In 2014, when visiting the United States again, Madeleine learned of the requirement to report worldwide income and the information reporting requirements associated with certain foreign financial assets and accounts, and realized that her retirement savings met the reporting thresholds.[9] When she returned to France, Madeleine attempted to comply but could not find free tax assistance. She became anxious about the potential FBAR and FATCA penalties that could negatively affect her retirement savings. As a result, she had to pay for tax preparation, plus an additional fee to discuss any FBAR and FATCA reporting questions with her advisor.[10] In addition, upon learning that Madeleine is a dual U.S.-French citizen, the small local bank where the couple had held joint accounts for over a decade suggested that the Legrands either close the accounts or remove Madeleine from them, so that the bank can avoid costs and risks associated with reporting and withholding obligations under FATCA.

RECOMMENDATIONS

To reduce the burdens of FATCA compliance, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6038D:
  - To eliminate duplicative reporting of assets on Form 8938, *Statement of Specified Foreign Financial Assets*, 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.
- Amend IRC § 1471 to specifically exclude from the definition of financial account subject to reporting by FFIs 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.

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8 *See, e.g.*, National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 93-4, 99; *Reporting of Specified Foreign Financial Assets*, Preamble to Final Regulations under IRC § 6038D, Summary of Comments and Explanation of Revisions, sec. V (G), 79 FR 73817-01 (Dec. 12, 2014); Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under Sections 6038D and 1471* (Oct. 13, 2015). *See also* Government Accountability Office (GAO), GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, App. 2 (Feb. 2012); TAS meetings with representatives of the Association of Americans Resident Overseas and the Federation of American Women's Clubs Overseas (Mar. 24, 2014 and Feb. 24, 2015); TAS meetings with Democrats Abroad Task Force on FATCA (Mar. 4, 2014 and Feb. 24, 2015).

9 For filing thresholds, see generally 31 U.S.C. § 5314(a); 31 C.F.R. § 1010.350; Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts, FinCEN Form 114 (2014) ($10,000 threshold). *See also* Treas. Reg. § 1.6038D–2(a).

10 TAS has been informed that this fee could be substantial, particularly for persons overseas. TAS meeting with representatives of the American Citizens Abroad (ACA) (Sept. 4, 2014).

PRESENT LAW

The law requires U.S. taxpayers to file a number of information returns and imposes severe civil penalties for failing to file, many of which are not based on the amount of the underpayment of tax.[11] Among the most publicized are the penalties for failure to disclose foreign financial accounts (FBAR) and foreign financial assets (FATCA). The Currency and Foreign Transaction Reporting Act of 1970 (commonly known as The Bank Secrecy Act) requires U.S. citizens and residents to report foreign accounts with an aggregate value of $10,000 or more at any time during the calendar year on the FBAR.[12] FATCA requires U.S. citizens, resident aliens, and certain non-resident aliens to file a Form 8938 with their individual returns reporting foreign assets exceeding specified thresholds.[13]

A taxpayer may be subject to a civil FBAR penalty of up to $10,000 per violation for failing to file an FBAR even if the failure was not "willful."[14] If the government establishes the failure was willful, the maximum penalty is the greater of $100,000 or 50 percent of the balance of the undisclosed account annually.[15] The taxpayer may also face criminal penalties of up to $500,000 and ten years in prison.[16] For taxable years beginning after March 18, 2010, pursuant to FATCA, an additional penalty of $10,000 (and of up to $50,000 for continued failure after IRS notification) is imposed on U.S. taxpayers holding financial assets outside the United States who fail to report those assets on Form 8938.[17] Underpayments of tax attributable to non-disclosed foreign financial assets are subject to an additional substantial understatement penalty of 40 percent.[18] Additionally, the statute of limitations is extended to six years if there is an omission of gross income in excess of $5,000 and the omitted gross income is attributable to a foreign financial asset.[19]

IRC § 1471(d)(1) defines the term "United States account" and provides for the elimination of duplicative reporting requirements.[20] The term "United States account" excludes financial accounts in FFIs if the holder of such account is otherwise subject to information reporting requirements

11 These penalties include but are not limited to penalties under IRC §§ 6038, 6038A, 6038B, 6038C, 6039F, 6046, 6046A. *See also* IRC §§ 6038D, 6662(b)(7); 31 U.S.C. § 5321(a)(5).

12 *See* 31 C.F.R. § 1010.306(c); Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts, FinCEN Form 114 (2014).

13 Treas. Reg. § 1.6038D-2(a). An unmarried taxpayer living in the U.S. must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. This threshold is doubled in the case of specified individuals who are married filing jointly. A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly. *Id*.

14 *See* 31 U.S.C. § 5321(a)(5)(B). Prior to October 22, 2004, there was no penalty for a non-willful failure to file and the maximum civil penalty for willful violations was $100,000. The American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 821(a), 118 Stat. 1418, 1586 (Oct. 22, 2004) established a penalty for non-willful violations and increased the penalty for willful violations.

15 31 U.S.C. § 5321(a)(5)(C). The penalty can reach 300 percent of the account balance if the willful failures continue over a six-year period. A six-year statute of limitations applies to the civil FBAR penalty. *See* 31 U.S.C. § 5321(b)(1).

16 31 U.S.C. § 5322; 31 C.F.R. § 1010.840(b). To establish willfulness for either civil or criminal penalties, the IRS generally has to establish that the taxpayer had knowledge of the FBAR filing requirement.

17 IRC § 6038D.

18 *See* IRC § 6662(b)(7).

19 IRC § 6501(e).

20 IRC § 1471(d)(1)(C).

which the IRS determines would make the reporting with respect to these accounts duplicative.[21] IRC § 1471(d)(1)(C)(ii) states:

> (C) Elimination of duplicative reporting requirements.--Such term shall not include any financial account in a foreign financial institution if —
>
> > (ii) the holder of such account is *otherwise subject to information reporting* requirements which the Secretary determines would make the reporting required by this section with respect to United States accounts *duplicative* (emphasis added).

Treasury Regulation § 1.1471–5(b)(2) provides specific exceptions to the definition of financial accounts subject to reporting by FFIs. Currently, the regulation does not provide an exception for 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.

Similarly, IRC § 6038D specifically authorizes the IRS to issue regulations or other guidance to provide appropriate exceptions from FATCA reporting when such reporting would be duplicative of other disclosures. IRC § 6038D(h)(1) provides that:

> The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including *regulations or other guidance which provide appropriate exceptions* from the application of this section in the case of —
>
> > (1) classes of assets identified by the Secretary, including any assets with respect to which the Secretary determines that disclosure under this section would be duplicative of other disclosures… (emphasis added).

Treasury Regulations under IRC § 6038D eliminate duplicative reporting of assets on the Form 8938 if the asset is reported or reflected on certain other timely-filed international information returns (*e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891) provided the Form 8938 indicates the filing of the form on which the asset is reported.[22] However, FinCEN Report 114 (FBAR) is not included on the list of those information returns.

Similarly, Treasury Regulation § 1.6038D-7(c)(1) provides that a *bona fide* resident of a U.S. possession who is required to file Form 8938 is *not required* to report financial accounts maintained by a financial institution organized under the laws of the U.S. possession of which the specified individual is a *bona fide* resident. The regulation currently does not have a similar exception for U.S. individuals who are *bona fide* residents of foreign countries.

21 IRC § 1471(d)(1)(C)(ii).

22 *See* Treas. Reg. § 1.6038D-7(a).

REASONS FOR CHANGE

Eliminate Duplicative Reporting

For several years, the National Taxpayer Advocate and other stakeholders have expressed concerns about the overlap of FBAR and the Form 8938, which must be filed with annual federal income tax returns.[23] The FinCEN Report 114 and the Form 8938 are significantly duplicative, increasing confusion and adding to the compliance burden for taxpayers.[24] Reporting and withholding obligations have resulted in additional costs and risks of substantial penalties for taxpayers and withholding agents, and might have prompted some FFIs to close accounts of U.S. taxpayers abroad.[25]

FATCA was passed in response to IRS and congressional concerns that U.S. taxpayers were not fully disclosing the extent of financial assets held abroad.[26] However, the IRS's approach to FATCA apparently is based on the unsubstantiated assumption that most taxpayers are "bad actors" and that a widespread, burdensome enforcement regime is necessary. Such has been the case even though the vast majority of taxpayers have been, and likely will continue to be, fully compliant. In her 2013 report, the National Taxpayer Advocate observed that based on analysis of the data then available " … to this point, the IRS is imposing additional reporting burdens and increased potential penalties primarily on a category of taxpayers that, under principles of quality tax administration, should be encouraged, rather than penalized."[27] Further review of updated and expanded data from fiscal year 2010 through the present continues to demonstrate tax evaders are not feeling the weight of FATCA; instead, the burden of FATCA falls on U.S. taxpayers who likely would be compliant regardless. U.S. taxpayers under the FATCA umbrella who must file Form 8938 are generally as compliant as the overall U.S. taxpayer population as shown on Figure 2.5.1.[28]

23 National Taxpayer Advocate 2013 Annual Report to Congress 238-48; National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 23; National Taxpayer Advocate 2012 Annual Report to Congress 134, 141; National Taxpayer Advocate 2011 Annual Report to Congress 129-272; Tax Analysts, *Texas CPAs Recommend Simplifying Foreign Financial Reporting*, 2015 TNT 167-13; GAO, GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, App. 2 (Feb. 2012).

24 IRS, *Comparison of Form 8938 and FBAR Requirements*, *available at* http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

25 Under FATCA, to avoid being withheld upon a 30 percent withholding tax on certain U.S.-source payments made to them, FFIs should register with the IRS and agree to report certain information about their U.S. accounts, including accounts of certain foreign entities with substantial U.S. owners. IRC §§ 1471-1474.

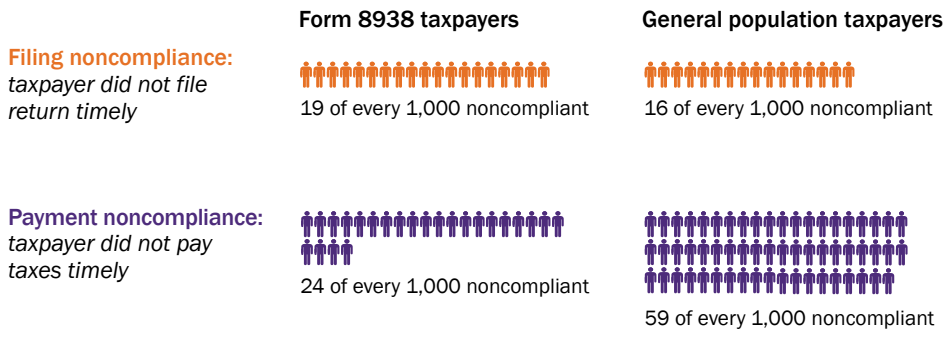
26 *See Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010).

27 National Taxpayer Advocate 2013 Annual Report to Congress 241.

28 National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 48-52 (Area of Focus: *The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*).

FIGURE 2.5.1[29]

Noncompliance Rates for Form 8938 Filers vs. General Population Taxpayers



The National Taxpayer Advocate previously has observed taxpayers' willingness to meet their reporting and filing obligations is driven more by considerations of personal integrity and perceptions of systemic fairness than by economic deterrence and enforcement measures.[30]

As of December 2015, approximately 300,000 taxpayers had filed Forms 8938 for tax year (TY) 2013, while about 283,000 had filed for TY 2014.[31] Of the taxpayers filing Forms 8938 in TY 2013, approximately 38 percent also filed FBAR forms.[32] Roughly 24 percent of Form 8938 returns were submitted to the IRS from a foreign address based on TY 2013 data.[33]

29 Data drawn from IRS Compliance Data Warehouse (CDW), IRTF Entity and IMF Status History tables (Mar. 26, 2015). This table uses status code 03 data (Tax Delinquency Investigation) to measure filing compliance and status code 22, 24, and 26 data (Tax Delinquent Account) to measure payment compliance. The analysis covers five tax years from 2009 forward. In addition, FATCA filers appear to have a lower level of reporting noncompliance than the general population because FATCA filers have a lower percentage of high-scoring DIF returns in comparison to filers overall. Data drawn April 13, 2015 from CDW, IRTF Entity table, Processing Year 2013. High-scoring DIF returns were defined as those with a DIF value that exceeded 80 percent of DIF scores in the general population for a particular TPI class. We calculated a cutoff point for DIF scores at the 80th percentile for each TPI class for Processing Year 2013 and calculated the percentage of FATCA filers in each TPI class that exceeded the DIF cutoff point. Only 16.5 percent of FATCA filers exceeded their respective DIF cutoff points, compared to, of course, 20 percent for individual filers in the general population. Thus, FATCA filers showed a lower percentage of "high-scoring" DIF returns than the overall population.

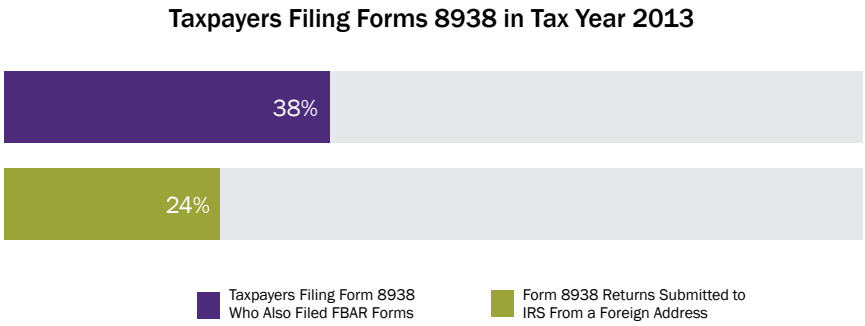
30 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 134.

31 TAS Research, CDW, IRFT Entity and IRTF F1040 tables, data drawn Nov. 16, 2015. These numbers may change as more TY 2013 and 2014 returns are filed with the IRS.

32 TAS Research, CDW, IRFT Entity and IRMF_F90_22 tables, data drawn Nov. 16, 2015.

33 IRS LB&I Division, Planning, Analysis, Inventory, and Research (PAIR) analysis, CDW, IMF_Entity table, data drawn Dec. 18, 2015.

FIGURE 2.5.2[34]



As noted above, the IRS has regulatory authority under FATCA to eliminate duplicative reporting on FATCA Form 8938 and FBAR. However, it repeatedly has declined to do so, citing the Joint Committee on Taxation (JCT) Technical Explanation accompanying the HIRE Act.[35] The Technical Explanation states that "[n]othing in this provision [section 511 of the HIRE Act enacting new section 6038D] is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision."[36] At the same time, as described above, the *statutory* language (as opposed to a JCT explanation) specifically authorizes elimination of duplicative reporting requirements.[37]

While the IRS may feel constrained in its regulatory authority to change the FBAR filing requirements, it is specifically granted the freedom to adjust FATCA filing requirements. The National Taxpayer Advocate is therefore baffled by the IRS's inexplicable unwillingness to address this unnecessary duplication of reporting requirements. It appears that congressional action specifically *requiring* the IRS to eliminate duplicative reporting under FATCA and FBAR is necessary to alleviate significant burdens being experienced by affected taxpayers and to protect the taxpayers' rights *to privacy* and *to a fair and just tax system*.

Same-Country Exception

As stated above, U.S. taxpayers residing abroad are subject to overlapping reporting requirements under FBAR and FATCA, which increase preparation expenses and the chance of error.

Additionally, organizations representing U.S. taxpayers abroad have voiced concerns about unintended consequences of new FATCA rules for FFIs that make it harder for U.S. taxpayers living abroad to open

34 TAS Research, CDW, IRFT Entity and IRMF_F90_22 tables, data drawn Nov. 16, 2015. IRS LB&I Division, PAIR analysis, CDW, IMF_Entity table, data drawn Dec. 18, 2015. These numbers will change as more TY 2013 returns are filed with the IRS.

35 *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010). *See also Reporting of Specified Foreign Financial Assets*, Preamble to Final Regulations under IRC § 6038D, Summary of Comments and Explanation of Revisions, sec. V (G), 79 FR 73817-01 (Dec. 12, 2014); Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under Sections 6038D and 1471* (Oct. 13, 2015); National Taxpayer Advocate 2015 Objectives Report to Congress 93-94, 99.

36 *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010) at 60.

37 IRC §§ 1471(d)(1)(C)(ii) and 6038D(h)(1).

and maintain legitimate bank accounts overseas.[38] Some FFIs, such as DeutcsheBank, HSBC, and ING, have reportedly closed out foreign accounts of U.S. citizens in response to FATCA to avoid significant costs and regulatory risks associated with preparing for and maintaining an ongoing FATCA compliance.[39] Other FFIs have severely restricted the services they offer to these customers.[40]

During recent meetings with TAS, organizations of U.S. citizens abroad reiterated their concerns about the difficulty of opening bank accounts in their countries of residency.[41] The National Taxpayer Advocate has personally received multiple reports from taxpayers, taxpayer representatives, and tax professionals residing in a range of countries including Austria, Hungary, and Sweden and from some foreign tax officials themselves.[42] Because FATCA creates burdens for FFIs, 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.

Similarly, substantial day-to-day compliance burdens and costs of implementing FATCA are placed on financial institutions.[43] For example, unless an FFI agrees to provide comprehensive information regarding accounts of U.S. taxpayers, a broad range of U.S.-source payments to that FFI are subject to a 30 percent withholding tax.[44] FATCA further charges withholding agents with the responsibility of determining whether they are obliged to undertake FATCA withholding and implementing that withholding when it is required.[45]

As a recommendation to help minimize the burden of FATCA compliance for both individual U.S. taxpayers residing abroad and FFIs, the National Taxpayer Advocate proposed that the IRS and Treasury adopt a "same-country exception."[46] Accounts opened by U.S. citizens in a foreign country of *bona fide* residence are not "offshore" accounts designed for tax avoidance. These *bona fide* residents have a legitimate need for local banking services in their countries of residence. Thus, it is more logical and in keep-

38 IRC §§ 1471-1474. *See, e.g.*, ACA Comments on the Proposed Treasury Regulations Concerning FATCA Dated February 8, 2012 (Apr. 4, 2012), *available at* https://www.americansabroad.org/files/6813/4192/6083/acastatementapril2012s.pdf (last visited Nov. 23, 2015); April Carvelli, *Taxes Pushing U.S. Citizens to Renounce*, Imperfect Parent (Apr. 17, 2012) (quoting Francisca N. Mordi, Vice President and Senior Tax Counsel at the American Bankers Association, who stated she received a number of calls from Americans in Europe complaining about banks closing their accounts. "They're going to drop Americans like hot potatoes," Mordi says. "The foreign banks are upset enough about the regulations that they're saying they just won't keep American customers, and it's giving (Americans living abroad) a lot of sleepless nights."), *available at* http://www.imperfectparent.com/topics/2012/04/17/taxes-pushing-u-s-citizens-to-renounce/; James Fellows, *The FATCA Chronicles: Tales From China, Canada, and Estonia*, The Atlantic (Jan. 3, 2012), *available at* http://www.theatlantic.com/international/archive/2012/01/the-fatca-chronicles-tales-from-china-canada-and-estonia/250771/; Judi Lembke, *Americans in Sweden Suffer U.S. Tax Crackdown*, The Local (Sweden's News in English) (Mar. 6, 2012), *available at* http://www.thelocal.se/39522/20120306/.

39 *See* National Taxpayer Advocate 2013 Annual Report to Congress 238.

40 *Id*.

41 TAS meetings with representatives of the Association of Americans Resident Overseas and the Federation of American Women's Clubs Overseas (Mar. 24, 2014 and Feb. 24, 2015); TAS meeting with Democrats Abroad Task Force on FATCA (Mar. 4, 2014 and Mar. 4, 2015).

42 National Taxpayer Advocate's meetings at the University of Vienna, Austria, Harvard Club of Hungary, Budapest, Hungary, and Swedish Tax Agency, Stockholm, Sweden.

43 Presentation of the National Taxpayer Advocate to the Securities Industry and Financial Markets Association (Oct. 7, 2014). *See also* Lee Sheppard, *News Analysis: The Reformation of FATCA*, 2015 TNT 92-1 (May 13, 2015).

44 IRC §§ 1471(a) and 1473(1). IRC § 1471(d)(1)(B) excepts from the reporting and withholding requirements those accounts that are held by individuals at the same FFI and have an aggregate value of $50,000 or less. Note that an FFI can provide information either as a participating FFI or pursuant to an intergovernmental agreement negotiated between the U.S. and the FFI's home country.

45 IRC §§ 1471-1474; Notice 2013-43, 2013-31 I.R.B. 113.

46 TAS Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 15, 2015) and (Apr. 24, 2014). *See also National Taxpayer Advocate Seeks End to Duplicative FATCA Reporting*, 2015 TNT 71-16 (Apr. 14, 2015).

ing with the spirit of FATCA to require information reporting on financial assets and accounts opened in a country other than one's country of residence.

The IRS could have significantly alleviated reporting burdens for U.S. persons who are *bona fide* residents in foreign countries by revising regulations under IRC §§ 6038D and 1471 to eliminate the requirement to report specified foreign financial assets on the Form 8938 if such persons have reported the assets on the FBAR. The IRS could also facilitate these taxpayers' legitimate need for local banking services in their countries of residence by excluding financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. persons are *bona fide* residents from FATCA reporting.[47] To this point, the IRS has not been willing to pursue these recommendations proposed by the National Taxpayer Advocate and supported by other stakeholders.[48] In response to the National Taxpayer Advocate's request that this proposal be included in the U.S. Department of the Treasury Office of Tax Policy and the IRS Priority Guidance Plan, the IRS Office of Chief Counsel maintained:

> Under longstanding U.S. tax policy, U.S. citizens are taxed on their worldwide income irrespective of where they reside. Section 6038D was enacted to provide the IRS with an effective means to ensure compliance by all U.S. taxpayers owning foreign financial assets, including those residing outside of the United States. Thus, it was decided that the regulations under section 1471 and 6038D should not provide a broad carve out (from either the FFI reporting rules or the taxpayer self-reporting requirements, respectively) for U.S. citizens residing abroad as proposed in [TAS Recommendations for Published Guidance under Sections 6038D and 1471]. However, please note that the section 6038D regulations provide very substantial reporting relief for most U.S. citizens who are *bona fide* residents of another country. The regulations do so by providing aggregate foreign financial asset reporting thresholds for U.S. citizens residing abroad that are very generous and substantially higher than those applicable to other U.S. taxpayers. As a result, only those U.S. taxpayers residing abroad who have very substantial foreign financial asset holdings are required to file a Form 8938.[49]

For "accidental" Americans who have lived abroad for most of their lives, as described in the example above, the increased thresholds may not achieve the intended result as their savings may exceed even the higher thresholds.[50] This is particularly true where the accounts subject to reporting contain retirement savings. As a result, these taxpayers will bear the cost of tax preparation expenses for duplicate reporting under FBAR and FATCA. Others excepted from FATCA reporting under the higher thresholds will bear

47 To qualify for foreign earned income exclusion and foreign housing exclusion or deduction, a U.S. citizen or resident alien (for tax purposes) must have a tax home in a foreign country, and either be a *bona fide* resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year (*bona fide* residence test), or be present in a foreign country or countries during at least 330 full days in any period of 12 consecutive months (physical presence test). IRC § 911(d)(2).

48 Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under Sections 6038D and 1471* (Oct. 13, 2015); TAS meetings with the Special Counsel to the Deputy Chief Counsel (Technical) (May 23, 2014 and June 17, 2015).

49 Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under IRC Sections 6038D and 1471* (Oct. 13, 2015).

50 A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly. Treas. Reg. § 1.6038D-2(a).

the risk of IRS audits due to potential FFI errors because FFIs are still required to report their accounts to the IRS on Forms 8966, *FATCA Report*.[51]

Both groups will face the increased risk of errors as the IRS has shut itself off from a two-way dialogue with taxpayers abroad by closing all IRS tax attaché posts and eliminating the Electronic Tax Law Assistance Program, which was the only free method for taxpayers abroad to ask and receive answers to their specific tax law questions without paying toll phone or fax charges.[52] Similarly, both groups will continue experiencing difficulties with opening or maintaining bank accounts unless the definition of financial accounts subject to reporting by FFIs under IRC § 1471(d) excludes accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a *bona fide* resident.

EXPLANATION OF RECOMMENDATIONS

Treasury Regulations under IRC § 6038D eliminate duplicative reporting of assets on the Form 8938 if the asset is reported or reflected on certain other timely-filed international information returns (*e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891) provided the Form 8938 indicates the filing of the form on which the asset is reported.[53] The proposed legislation will achieve similar results by eliminating duplicative information reporting under FBAR. The proposed legislative change will not jeopardize the IRS's access to foreign financial account information reported on FBARs. The IRS has access to the FinCEN Query System, which allows IRS employees direct electronic access to FBAR data.

This legislative proposal would also exclude from FATCA coverage foreign financial assets held in the country in which a U.S. taxpayer is a *bona fide* resident. It would mitigate concerns about the collateral consequences of FATCA raised by U.S. non-residents, reduce reporting burdens faced by FFIs, and allow the IRS to focus its enforcement efforts on identifying and addressing willful attempts at tax evasion through foreign accounts.[54] From a technical perspective this exception is substantially similar to the regulatory exception provided to *bona fide* residents of U.S. territories.[55]

Information reporting can be very useful and can influence taxpayer behavior and future compliance, provided it is narrowly tailored to accomplish a reasonable result. The proposed legislative recommendations enhance taxpayer *rights to privacy* and *to a fair and just tax system* without inhibiting the IRS's ability to obtain information about financial accounts maintained by FFIs outside the U.S. person's country of *bona fide* residency.

51 Reaching the IRS to address inadvertent errors would be especially problematic given the decline in phone service over the recent year. In FY 2013, the average wait time on the international phone line was 10.5 minutes, compared to 19.9 minutes in FY 2015, a 90 percent increase. Furthermore, the average level of service on the international phone line in FY 2015 was only 55 percent. *See* Most Serious Problem: *International Taxpayer Service: The IRS's Service on Demand Strategy Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*, *supra*.

52 *Id*.

53 *See* Treas. Reg. § 1.6038D-7(a).

54 A workable same-country exception would require the development of detailed guidance from the IRS, ideally arrived in consultation with FFIs and other stakeholders. One potential starting point would be to allow an FFI to accept the self-reporting of its accountholders to the extent that this reliance is reasonable under the facts and circumstances known to the FFI.

55 *See* Treas. Reg. § 1.6038D-7(c).

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

TAXPAYER RIGHTS IMPACTED[1]

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

PROBLEM

Indian Tribal Governments (ITGs) have a unique status for federal tax purposes.[2] In 1983, Congress enacted Internal Revenue Code (IRC) § 7871 which provides that ITGs are treated as States for certain tax purposes,[3] acknowledging that, in many respects, ITGs function like States and should therefore be treated as such.[4] 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.[5] However, ITGs are not treated as States for the purpose of Social Security taxes. Thus, unlike State employees, ITG employees who are covered by a State retirement plan are not excepted from Social Security taxes.[6] 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.[7] It also undermines ITG taxpayers' *right to a fair and just tax system*.

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 For a discussion of the various federal tax provisions applicable to ITGs, see Joint Committee on Taxation, *Overview of Federal Tax Provision and Analysis of Selected Issues Relating to Native American Tribes and Their Members*, JCX-40-12 (May 14, 2012).

3 *See* IRC § 7871(a). These include the ability to receive tax deductible charitable contributions for income, estate, and gift tax purposes, the special treatment afforded to States for certain excise taxes, the ability to deduct taxes paid to an ITG, and the issuance of tax-exempt government bonds. ITGs are also treated as States for other purposes that are set forth in IRC § 7871(a).

4 This section was originally enacted by the Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, § 202(a), 96 Stat. 2605, 2608-11 (1983). It has been amended several times since the initial enactment.

5 *See* Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, § 166, 114 Stat. 2763, 2763A-627 (2000). This legislation amended FUTA provisions contained in IRC §§ 3306 and 3309 to provide that ITGs are to be treated like State and local governments for FUTA purposes. *See* IRC §§ 3306(c), 3306(u), and 3309. *See also* Announcement 2001-16, 2001-1 C.B. 715 (providing guidance to ITGs on FUTA obligations).

6 IRC § 3121(b)(7)(F).

7 *See* Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202, 124 Stat. 2261, 2262 (2010) (noting that domestic and sexual violence against American Indian and Alaska Native women has reached epidemic proportions and that Indian tribes have experienced significant increases in domestic violence, burglary, assault, and child abuse on Indian reservations). *See also* Timothy Williams, *Higher Crime, Fewer Charges on Indian Land*, N.Y. Times, Feb. 20, 2012, *available at* http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?_r=0 (citing Department of Justice (DOJ) data that the country's 310 Indian reservations have violent crime rates that are more than two and a half times higher than the national average).

EXAMPLE

An ITG is facing an increase in crime on its land. To deal with this increase, the tribe seeks to recruit additional police officers and is also concerned about the retention of its current police officers. The tribe is located within a State that, to incentivize the recruitment and retention of qualified police officers, offers a retirement plan with excellent benefits to State police officers. Under IRC § 3121(b)(7)(F), State police officers who are covered by this retirement plan are excepted from paying Social Security taxes.

To facilitate recruitment and retention of police officers, the tribe has entered into an agreement with the State that permits police officers employed by the tribe to participate in the State's retirement plan. However, because tribal police officers are technically employees of the tribe and not the State, they are not excepted from Social Security taxes. Therefore, if they wish to participate in the State retirement plan, the tribal police officers and the ITG must pay into both Social Security and the State retirement system. This inconsistent treatment between State and tribal police officers has an adverse effect on the tribe's ability to recruit and retain tribal police officers and places an economic burden on the tribe, which is attempting to address the increase in crime on tribal lands.

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."

PRESENT LAW

The Federal Insurance Contributions Act (FICA) provisions in the IRC provide for Social Security taxes (also referred to old age, survivors, and disability insurance, or OASDI) on both employers and employees.[8] IRC § 3101(a) imposes on the income of every individual a 6.2 percent Social Security tax on the wages (as defined in IRC § 3121(a)) received with respect to employment (as defined in IRC § 3121(b)). IRC § 3111(a) imposes on every employer, with respect to having individuals in its employ, a 6.2 percent Social Security excise tax on wages (as defined in IRC § 3121(b)).

IRC § 3121(b)(7)(F) provides an exception to the term "employment" for Social Security tax purposes and states that services performed in the employ of a State, or any political subdivision thereof, or any instrumentality, are not subject to Social Security taxes. However, this exception does not apply unless the employee is covered by a retirement plan of the State, political subdivision, or instrumentality.

IRC § 7871(a) provides that ITGs shall be treated as States for certain purposes enumerated in this section. However, this section does not provide that ITGs should be treated as States for the purpose of Social Security taxes.

REASONS FOR CHANGE

In previous Annual Reports to Congress, the National Taxpayer Advocate has written about the unique needs of ITG taxpayers as well as made a legislative recommendation to treat ITGs as States for the

8 The FICA provisions are contained in Subtitle C, Chapter 21 of the IRC. FICA taxes also include Medicare taxes (also called hospital insurance, or HI) and the Additional Medicare tax, but these are not at issue here.

purpose of the adoption credit in IRC § 23.[9] ITGs have a unique status for federal tax purposes.[10] IRC § 7871 provides that ITGs are treated as States for certain tax purposes set forth in that section.[11] These include the ability to receive tax deductible charitable contributions for income, estate, and gift tax purposes,[12] the special treatment afforded to States for certain excise taxes,[13] the ability to deduct taxes paid to an ITG,[14] and the issuance of tax-exempt government bonds.[15] In the legislative history of IRC § 7871, a report of the Senate Committee on Finance provides the reason that Congress chose to treat ITGs as States for certain purposes. It states:

> Many Indian tribal governments exercise sovereign powers; often this fact has been recognized by the United States by treaty. With the power to tax, the power of eminent domain, and police powers, many Indian tribal governments have responsibilities and needs quite similar to those of State and local governments. Increasingly, Indian Tribal governments have sought funds with which they could assist their people by stimulating their tribal economies and by providing governmental services. The committee has concluded that, in order to facilitate these efforts of the Indian tribal governments that exercise such sovereign powers, it is appropriate to provide these governments with a status under the Internal Revenue Code similar to what is now provided for the governments of the States of the United States.[16]

Thus, in enacting IRC § 7871, Congress acknowledged that, in many respects, ITGs function like States and should therefore be treated like them for certain federal tax purposes.

More recently, in 2000, Congress decided that ITGs should be treated as States with regard to FUTA taxes.[17] Under FUTA, employers must pay a six percent tax on total wages paid with respect to covered employment.[18] The change in law allowed ITGs, like State governments, to elect to pay FUTA taxes only when a former employee claims unemployment benefits.[19] Therefore, for FUTA tax purposes, ITGs are treated identically to States.

Regarding Social Security taxes under FICA, in 1990, Congress was concerned about State and local government employees who were neither covered by a State retirement system or through the federal Social

9 *See* National Taxpayer Advocate 2013 Annual Report to Congress 116 (Most Serious Problem: *Indian Tribal Taxpayers: Inadequate Consideration of Their Unique Needs Causes Burdens*); National Taxpayer Advocate 2012 Annual Report to Congress 521 (Legislative Recommendation: *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes*).

10 For a discussion of the various federal tax provisions applicable to ITGs, see Joint Committee on Taxation, *Overview of Federal Tax Provision and Analysis of Selected Issues Relating to Native American Tribes and Their Members*, JCX-40-12 (May 14, 2012).

11 This section was originally enacted by the Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, § 202(a), 96 Stat. 2605, 2608-11 (1983). It has been amended a few times since the initial enactment.

12 IRC § 7871(a)(1).

13 IRC § 7871(a)(2).

14 IRC § 7871(a)(3).

15 IRC § 7871(a)(4). ITGs are also treated as States for other purposes that are set forth in IRC § 7871(a).

16 S. Rep. No. 97-646, at 11 (1982).

17 *See* Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, § 166, 114 Stat. 2763, 2763A-627 (2000). This legislation amended FUTA provisions contained in IRC §§ 3306 and 3309 to provide that ITGs are to be treated like State and local governments for FUTA purposes. See IRC §§ 3306(c), 3306(u), and 3309. *See also* Announcement 2001-16, 2001-1 C.B. 715 (providing guidance to tribes on FUTA obligations).

18 The FUTA provisions are contained in IRC §§ 3301-3311.

19 IRC § 3309(d).

Security program.[20] It therefore enacted legislation to require Social Security coverage for State or local government employees who were not covered by a retirement system in conjunction with their employment.[21] However, Congress provided a Social Security tax coverage exception for State employees who are actually covered (*i.e.*, not simply eligible to participate) by a State retirement plan.[22]

When enacting IRC § 7871 in 1983, Congress recognized the unique attributes of ITGs and how they have similar needs and characteristics as States and should therefore be treated as States for many tax purposes. Similarly, in 2000, Congress decided to treat ITGs as States for FUTA tax purposes.

ITGs face high levels of crime, particularly violent crime, on tribal lands.[23] 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.[24] Specifically, one of the purposes of this legislation was "to empower tribal governments with the authority, resources, and information necessary to safely and effectively provide public safety in Indian country."[25] This law also, among other things, expands efforts to recruit, train, and retain tribal police officers.[26]

An ITG grappling with a surge in crime will naturally seek to recruit additional tribal police officers and do its best to retain its current ones. To facilitate recruitment and retention, an ITG will likely attempt to put forth attractive compensation packages for tribal police officers, including offering favorable retirement benefits. Due to complex jurisdictional issues on Indian tribal lands, an ITG will often enter into agreements with State (and federal) authorities to coordinate law enforcement efforts.[27] 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 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.[28] 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 pension plans.

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20 *See* Staff of H. Comm. of Ways and Means, 101st Cong., Legislative History of Ways and Means Democratic Alternative, Ways and Means Comm. Print No. 101-37, at 86-87 (1990).

21 *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, Title XI, § 11332(b), 104 Stat. 1388, 1388-469 (1990).

22 *See* IRC § 3121(b)(7)(F).

23 *See* Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202, 124 Stat. 2261, 2262 (2010) (noting that domestic and sexual violence against American Indian and Alaska Native women has reached epidemic proportions and that Indian tribes have experienced significant increases in domestic violence, burglary, assault, and child abuse on Indian reservations); *see also*, *e.g.*, Timothy Williams, *Higher Crime, Fewer Charges on Indian Land*, N.Y. Times, Feb. 20, 2012, *available at* http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?_r=0 (citing DOJ data that the country's 310 Indian reservations have violent crime rates that are more than two and a half times higher than the national average).

24 *See* Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 201, 124 Stat. 2261 (2010). *See also* DOJ, *Tribal Law and Order Act*, *available at* http://www.justice.gov/tribal/tribal-law-and-order-act.

25 *See* Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202(b)(3), 124 Stat. 2261, 2263 (2010).

26 *See* DOJ, *Tribal Law and Order Act*, *available at* http://www.justice.gov/tribal/tribal-law-and-order-act.

27 *See* Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202(a)(4)(C), 124 Stat. 2261, 2262 (2010) (noting that the complicated jurisdictional scheme in Indian country requires a high degree of commitment and cooperation among tribal, federal, and State law enforcement officials).

28 *See* IRC § 3121(b)(7)(F).

More importantly, the inconsistency in tax treatment of ITGs and tribal police officers for Social Security tax purposes as compared to their counterparts employed by States appears to run contrary to congressional intent in reducing crime, particularly violent crime, on Indian lands.

To address this inequity and the compliance burdens placed on ITGs and tribal officers (and other ITG employees), to provide uniform treatment of ITGs as States for all employment tax purposes, and to comport with congressional intent in addressing crime on ITG lands, Congress should 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. This would mean that ITG police officers who participate in a State retirement plan, as well as the ITG, would not be responsible for Social Security taxes. In making this legislative change, Congress can align both tax and non-tax legislation impacting ITGs.

EXPLANATION OF RECOMMENDATION

The proposal to amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as States would allow ITGs to better recruit and retain tribal police officers to address crime on Indian tribal lands, which has been a goal of Congress in non-tax legislation.[29] This proposal would provide parity between ITG and State law enforcement officers and would also be in line with prior congressional action treating ITGs as States for IRC § 7871 and FUTA purposes. This change would also protect the fundamental taxpayer *right to a fair and just tax system*.

29 Technically speaking, this proposal would amend IRC § 7871(a) to include a provision similar to IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as States. Simply treating ITGs as a State under IRC § 3121(b)(7)(F) would not achieve the desired result because the tribal police officer or other ITG employee would not be participating in an ITG retirement plan but rather a State retirement plan. However, the goal of this proposal is to extend the benefits of IRC § 3121(b)(7)(F) to ITG employees, particularly ITG tribal police officers, who participate in a State retirement plan.

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*

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal the IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The 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 a taxpayer's nonexempt 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 such property to that person within certain time periods. The IRS also may return levied property to the taxpayer if certain conditions are met, and it must return levied property to a taxpayer, however, only if the levy was in violation of the law.[2] Under IRC § 6343(b), the IRS may only return money levied upon or money received from sale of property nine months from the date of levy.[3] A person other than a taxpayer (*i.e.* a third party) may file a civil suit against the United States for a wrongful levy under IRC § 7426, but under IRC § 6532(c), the civil suit must be brought by the third party within nine months from the date of the levy that gave rise to the action.[4] However, a taxpayer who is requesting the return of levied property generally may not bring suit if the IRS denies the taxpayer's request to return the property.[5] Therefore, if a third party or taxpayer files a request with the IRS, or if a third party files a civil suit under IRC § 7426 for return of levied proceeds without first filing a request for return of the property under IRC § 6343(b) after the nine-month period has expired, neither the IRS nor the court has authority to consider the claim.

1 *See* Taxpayer Bill of Rights, *available at* http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 *See* IRC §§ 6343(b) and (d); Treas. Reg. § 301.6343-3(d). The IRS is required to return the levied upon property if the levy was wrongful, premature, or in violation of the law. The IRS has discretion to return levied upon property if "(A) the levy was not in accordance with administrative procedures of the Secretary, (B) the taxpayer has entered into an agreement under section 6159 to satisfy the tax liability for which the levy was imposed by means of installment payments, unless such agreement provides otherwise, (C) the return of such property will facilitate the collection of the tax liability, or (D) with the consent of the taxpayer or the National Taxpayer Advocate, the return of such property would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States."

3 IRC § 6343(b); Treas. Reg. § 301.6343-3.

4 IRC § 6532(c); Treas. Reg. § 301.6532-3. This nine-month period can be extended if the taxpayer files a claim for return of levy proceeds with the IRS within nine months of the date of the levy. It will be extended to the shorter of 12 months from the date of filing by a third party of a written request for the return of the property wrongfully levied upon, or six months from the date of mailing a notice of disallowance. A request which does not meet the requirements under Treas. Reg. § 301.6343–2(b)(3) is not considered adequate and will not extend the nine-month period.

5 A taxpayer may file suit for certain unauthorized collection actions that violated the law or a regulation under IRC § 7433, but the suit must be filed within two years of the date that the right of action accrues.

Unlike IRC § 6511(h), which suspends the running of the period for filing a claim for refund when a taxpayer can show that he or she was financially disabled,[6] neither IRC § 6343, the relevant Treasury Regulations (Treas. Reg.), or IRC § 6532(c) provides for any such suspension.[7] The absence of a suspension of the nine-month time period when a taxpayer or an individual who is a third party, that is financially disabled fails to protect the *rights to pay no more than the correct amount of tax*, *to appeal an IRS decision in an independent forum, to privacy*, and *to a fair and just tax system*, and for financially disabled taxpayers or individuals who are third parties who lack the capacity to file a claim during that short time period. Even if Congress extends the nine-month period to two years, as recommended previously by the National Taxpayer Advocate and as proposed in several bills,[8] the running of the two-year period should be suspended for the person's disability, because the same arguments apply — and especially because IRC § 6511 has the same two-year timeframe.

EXAMPLES

Example One: A Levy Wrongfully Served on a Third-Party's Bank Account

Fred and Mary Jones reside in a non-community property state. Fred Jones owes delinquent tax for taxable year (TY) 2007, when his filing status was single. In addition, Fred and Mary Jones owe delinquent tax for returns they filed jointly for TYs 2008 and 2009. In 2010, the IRS mistakenly levies Mary's bank for all three taxable years. This results in money from Mary's bank account being used to pay liabilities for all taxable years, including Fred's separate TY 2007 liability. In the beginning of 2010, Fred and Mary separated due to financial stress. As a result of the separation and financial stress, Mary was suffering from severe clinical depression, which impaired her ability to complete day-to-day tasks and manage her financial affairs. Mary's illness prevented her from submitting a request for return of levy proceeds until 18 months from the time the levy attached to the bank account. The IRS rejected Mary's late-filed request for the return of the wrongly levied property because it was not submitted within the nine-month time period. Mary is barred from filing a civil suit for return of the wrongfully levied proceeds because IRC § 6532(c)(1) prohibits a suit once the nine-month period has expired if there was not a timely-filed claim.

Example Two: A Levy Was Filed Prematurely

John Doe suffers from Post-Traumatic Stress Disorder (PTSD) following his active combat duty. John Doe had tax liabilities for TYs 2008 and 2009. On January 1, 2010, the IRS filed a levy against his bank account. However, the IRS had not issued Mr. Doe a notice of intent to levy and his right to a collection due process hearing prior to filing the levy under IRC § 6330. During 2010, John Doe continued to suffer from severe PTSD, which crippled his ability to hold down a job, manage his financial affairs, and maintain personal relationships. In January 2011, with the assistance of a close family member, John Doe

6 Congress was concerned about similar unfair outcomes and has acted with legislation to address inequities associated with taxpayers' inability to manage financial affairs, and to strike a better balance between the tax system's need for finality and taxpayer's *right to a fair and just tax system*. Pub. L. No. 105-206 (July 1998) amended IRC § 6511, adding subsection (h), which provides that a person is financially disabled when he or she is "unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months."

7 National Taxpayer Advocate 2013 Annual Report to Congress 302-10 (Legislative Recommendation: *Broaden Relief from Timeframes for Filing a Claim for Refund for Taxpayers with Physical or Mental Impairments*).

8 National Taxpayer Advocate 2001 Annual Report to Congress 202. A bill was recently introduced in the United States Senate that included the National Taxpayer Advocate's recommendation and would extend the nine-month period in IRC § 6532(c) to two years. Taxpayer Bill of Rights Enhancement Act of 2015, S.1578, 114th Cong. (2015). Senator Cornyn and Representative Thornberry introduced companion bills that would extend the nine-month period in IRC § 6532(c) to three years. S. 949, 114th Cong. (2015) and H.R. 1828, 114th Cong. (2015).

was able to file a request for return of levy proceeds. Because the request was filed more than nine months from the date of levy, the IRS would be barred from considering his claim.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6343(b) to suspend the period in which the IRS has to return levy proceeds during any period in which a taxpayer or a third party who is an individual is financially disabled. A taxpayer or a third party who is an individual will not be considered to be financially disabled unless proof of the existence of a physical or mental disability is furnished in such a form and manner as the Secretary may require.
- Amend IRC § 6532(c) to suspend the period in which a third party who is an individual can file a civil suit for return of wrongfully levied proceeds during any period within that time in which that individual is financially disabled. An individual will not be considered to be financially disabled unless proof of the existence of a physical or mental disability is furnished in such form and manner as the Secretary may require.
- Adopt the National Taxpayer Advocate's definition of financial disability:[9]
  - Replace the existing requirement that the individual impairment be medically determinable with a provision that it be determined by a qualified medical or mental health professional. For this purpose, Congress should specify that a qualified medical or mental health professional is an individual who is licensed by the state in which he or she practices to provide direct medical or mental health treatment to another individual.
  - Replace the existing requirement that the impairment leave the individual unable to manage his financial affairs with the requirement that the impairment materially limit the management of those affairs.

The National Taxpayer Advocate reiterates her recommendation that the nine-month period for requesting return of levied property under IRC § 6343(b) should be extended to two years.[10]

PRESENT LAW

Under IRC § 6331, the IRS is authorized to collect outstanding tax by levying against the taxpayer's nonexempt property and rights to property. In certain situations, however, under IRC § 6343 and the regulations, levies must be released, and levied property may, or in some situations must, be returned to its owner. The IRS is authorized to return levy proceeds to either a taxpayer when the levy was erroneous (*i.e.*, in violation of law or IRS administrative procedures) or a third party whose property has been wrongfully levied (*i.e.*, property in which the taxpayer has no rights and that is not otherwise subject to the Federal tax lien).

Return of Wrongfully Levied Amounts to Third Parties Under IRC § 6343(b)

Under this provision, the IRS may return levied property or money when the levy incorrectly attaches to property belonging to a third party in which the taxpayer has no property rights and that is not otherwise

9 National Taxpayer Advocate 2013 Annual Report to Congress 302.

10 National Taxpayer Advocate 2006 Annual Report to Congress 547.

subject to the federal tax lien.[11] This is commonly known as a "wrongful levy." An individual can bring a civil suit against the IRS for return of the levied proceeds under IRC § 7426. Under IRC § 6532, this suit is barred from beginning no later than nine months from the date of the levy if no timely administrative request is first made by the third party.[12]

Return of Taxpayer's Erroneously Levied Proceeds Under IRC § 6343(d)

Under this provision, the IRS may return levied property or money in the following situations:

- A levy that is premature or not in accordance with administrative procedures;
- An installment agreement is made for a liability included on the levy, unless the agreement provides otherwise;
- Returning levy proceeds facilitates collection; and
- With the consent of the taxpayer or the National Taxpayer Advocate, returning the levy proceeds is in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.[13]

Return of Taxpayer's Erroneously Levied Property or Money Under Treasury Regulation § 301.6343-3(d)

Under Treas. Reg. § 301.6343-3(d), the IRS must return property or money that was levied in violation of law.[14] For example, under this regulation, the IRS must return property or money that is levied:

- Without giving the requisite 30-day notice of the right to a Collection Due Process hearing if required;[15]
- During the pendency of a proceeding for refund of divisible tax;[16]
- Before investigation of the status of levied upon property;[17] and
- During the pendency of an offer in compromise.[18]

Time Period Under IRC § 6343(b) in Which the IRS Can Return Levied Property or Money to Taxpayer or Third Party

In all the situations above, levied upon property other than money can be returned to a taxpayer or third party at any time.[19] However, the Treasury Regulations require a written request (described below) for return of levied money or money received from a sale of property within nine months from the date of the levy.[20]

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11 IRC §§ 6343(b) and 6331(a).

12 National Taxpayer Advocate 2001 Annual Report to Congress 202. Several bills were recently introduced in the United States Congress that included the National Taxpayer Advocate's recommendation and would extend the nine-month period in IRC § 6532(c) to two or three years. *See* S.1578, 114th Cong. (2015), S. 949, 114th Cong. (2015), and H.R. 1828, 114th Cong. (2015).

13 IRC § 6343(d).

14 Treas. Reg. § 301.6343-3(d).

15 *See* IRC § 6330(a)(1).

16 IRC § 6331(i).

17 IRC § 6331(j).

18 IRC § 6331(k)(1).

19 IRC § 6343(b)(1); Treas. Reg. § 301.6343-3(e).

20 Treas. Reg. §§ 301.6343-2 and 301.6343-3.

Time Period in Which a Third Party Who Has Had Property Wrongfully Seized and/or Sold by the IRS Can File Suit Under IRC § 7426

Under IRC § 7426, a third party may file suit against the United States in the Federal District Court to enjoin the IRS from proceeding with enforcement of the levy, to return the specific property, or to grant a judgment.[21] For a suit under IRC § 7426 to be timely, IRC § 6532 requires that it must be commenced from within nine months from the date of the levy if no request was made for the return of the levied property.[22] However, if a written request for return of wrongfully levied property or money is submitted to the IRS within nine months from the date of the levy, the nine-month period will be extended 12 months from the date of filing the written request for the return of property wrongfully levied upon, or six months from the date of mailing the notice of disallowance, whichever is shorter.[23] A request which does not meet the requirements under Treas. Reg. § 301.6343–2(b)(3) is not considered adequate and will not extend the nine-month period.

The Doctrine of Equitable Tolling

The doctrine of equitable tolling prevents a statute of limitations from barring a claim if the claimant, despite diligent efforts, did not discover the injury until after the expiration of the limitations period or under the circumstances, could not reasonably be expected to file the claim within the designated time period.[24] In *Irwin v. Dept. of Veterans Affairs*,[25] the Court held that when Congress has waived the government's sovereign immunity, thereby subjecting it to lawsuits, equitable tolling should be made applicable in the same way that it is applicable to private suits.

Applying the holding in the *Irwin* decision, the 9th Circuit recently reaffirmed its prior interpretation that equitable tolling applies to the time limitation for filing a wrongful levy suit under IRC § 6532(c).[26] In *Volpicelli v. U.S.*, the plaintiff had filed a wrongful levy suit under IRC § 7426(a)(1) about eight years after the nine-month period for bringing a suit under IRC § 6532(c) had expired.[27] The plaintiff alleged when he was ten years old, the IRS had levied on checks that represented gifts from his great-grandmother to be used for his college attendance. The IRS applied the funds instead to the plaintiff's father's unrelated tax bill. Nearly a year after the plaintiff turned 18 (the age of majority), he brought the wrongful levy suit in Nevada district court. That court threw out the suit, holding that the nine-month period was not subject to equitable tolling.[28] The 9th Circuit reversed the district court, contrary to other courts including the 3rd Circuit,[29] holding that the nine-month period in IRC § 6532(c) is not jurisdictional

21 IRC § 7426(b). The court can grant an amount of money levied upon or judgment in an amount not to exceed what the IRS received for the sale of the property.

22 IRC § 7426(i) cross references IRC § 6532(c) for period of limitations for filing a suit.

23 IRC § 6532(c).

24 Black's Law Dictionary (10th ed. 2014).

25 498 U.S. 1075 (1991).

26 Prior to *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015), the 9th Circuit in *Supermail Cargo, Inc. v. U.S.*, 68 F.3d 1204, 1206-07 (9th Cir. 1995) and *Capital Tracing, Inc. v. U.S.* 63 F.3d 859, 861-62 (9th Cir. 1995) applied the then-recent Supreme Court opinion in *Irwin v. Dept. of Veterans Affairs*, 498 U.S. 89 (1990), which held that the same rebuttable presumption in suits among private litigants that statutory periods of limitations could be subject to equitable tolling applied in analogous suits involving the United States. The 9th Circuit made two separate holdings: first, IRC § 6532(c) is not "jurisdictional", such as the 90-day period, or 150 days if the statutory notice of deficiency was sent outside the United States, for petitioning the United States Tax Court. Second, IRC § 6532(c) was a common statutory period of limitation, and there was nothing to rebut the *Irwin* presumption in favor of tolling.

27 *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015).

28 *Volpicelli v. U.S.,* 108 A.F.T.R.2d 2011-7409.

29 *Becton Dickinson and Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000).

and is subject to equitable tolling.[30] The 9th Circuit remanded the case to the district court to decide, in the first instance, whether tolling was justified.

Equitable tolling has been found not applicable to other statutory time periods in tax administration. The Supreme Court in *U.S. v. Brockamp* and the 4th Circuit in *Webb v. U.S.* declined to toll IRC § 6511.[31] In *Brockamp*, the taxpayer, who was 93 years old and demonstrating early signs of dementia, mailed a check to the IRS for $7,000 instead of $700, along with an application for an automatic extension of time to file his 1983 tax return. The taxpayer never sent in the 1983 return. The taxpayer died intestate more than two years after this payment. His daughter, administrator of the estate, discovered the $7,000 overpayment and requested in a letter to the IRS that the overpayment be refunded. In the letter she characterized her father as "senile" and stated that he had mistakenly sent the check for $7,000 rather than $700. The claim for refund was denied by the IRS on the basis that the statutory period of limitations under IRC § 6511 expired.[32]

In *Webb*, the taxpayer was physically and mentally abused and drugged by trusted caretakers (*i.e.*, her personal physician and an attorney hired by the physician) who coerced the taxpayer into granting them power of attorney over her finances.[33] The caretakers ultimately stole money from the taxpayer and filed gift tax returns reporting the stolen money as a gift to the caretakers from the taxpayer. With the assistance of a friend, the taxpayer eventually broke free of the abusive caretakers and filed a refund claim seeking a return of the paid gift taxes. The IRS denied claims for amounts beyond three years of the filing of the gift tax return because the statutory period of limitations under IRC § 6511 had expired.

Despite these taxpayers' inability to comply with the statutory limitations period due to impairments, both the Supreme Court and the 4th Circuit held that equitable tolling did not apply because the requirements of IRC § 6511 were already set out with specificity. It was in response to these cases that Congress enacted IRC § 6511(h).[34]

The amendment in IRC § 6511(h) suspended the running of the three- or two-year time period in IRC § 6511(a) during any period in which a taxpayer is financially disabled. The amendment states that a person is financially disabled:

> [I]f such individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.

REASONS FOR CHANGE

The law, as currently written, prevents the IRS and the courts from returning levied property in situations where the taxpayer or a third party who is an individual, 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. As mentioned above, Congress has already expressed concerns about similar outcomes in other provisions

30 *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015).

31 *U.S. v. Brockamp*, 519 U.S. 347 (1997), and *Webb v. U.S.*, 66 F.3d 691 (4th Cir. 1995).

32 *U.S. v. Brockamp*, 519 U.S. 347 (1997).

33 *Webb v. U.S.,* 66 F.3d 691 (4th Cir. 1995).

34 After the *Webb and Brockamp* cases, both Congress and the White House realized a legislative fix was needed. *See* Office of the White House Secretary, Press Release, Jan. 31, 1996; S. Rep. No. 105-174, at 60 (1998); H.R. Rep. No. 105-364, at 62 (1997). Both the House and the Senate reports show the Committees believed "that in cases of severe disability, equitable tolling should be considered in the application of the statutory limitations on the filing of tax refund claims."

relating to statutory periods of limitation. Specifically, under IRC § 6511(h), the running of the three- or two-year time period for filing a claim for refund is suspended during any period in which a taxpayer is financially disabled. By passing IRC § 6511(h), Congress ensured that taxpayers who were impaired from filing a timely claim for refund would not lose the opportunity to file such a claim altogether.

The current nine-month time period in IRC §§ 6343(b) and 6532(c) creates the same potential for harm that was experienced by the taxpayers in the *Webb* and *Brockamp* cases. As with IRC § 6511(h), to ensure that an impaired third party or who is an individual or a taxpayer is able to have his or her request for return of levy proceeds considered by either the IRS or the courts, the nine-month period should be tolled if the third party who is an individual or taxpayer can show that he or she was financially disabled during such period. Without this change, a taxpayer or other third party who is an individual who is impaired, and therefore prevented from requesting the return of a levied amount, 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. Tolling the period for filing a claim during the period in which a taxpayer or third party who is an individual is financially disabled would strike a better balance between finality for the IRS and the taxpayer's *right to a fair and just tax system*. This would also better protect a taxpayer's *rights to privacy*, *to pay no more than the correct amount of tax*, and *to appeal an IRS decision in an independent forum*.

Although IRC § 6511(h) provided relief for financially disabled taxpayers and is a helpful guide for amending IRC §§ 6343(b) and 6532(c) its narrow definition of financial disability leaves unprotected a number of third parties who are individuals and taxpayers who lack the capacity to manage financial affairs.[35]

To ensure the provision protects all taxpayers and third parties who are individuals who lack the capacity to manage their financial affairs, Congress should adopt the definition of financial disability recommended by the National Taxpayer Advocate in her 2013 Annual Report to Congress when amending IRC §§ 6343(b) and 6532(c).[36]

This definition of financial disability would provide relief to those who can complete certain tasks but are prevented by their disability from completing others. More specifically, in many cases a disability can materially limit particular aspects of an individual's conduct, which may cause the taxpayer or third party who is an individual to fail to file the request within the nine-month period. For instance, for an individual suffering from clinical depression, a simple, routine task may pose little anxiety, while a more difficult and complex task (*e.g.*, filing a refund claim) may trigger severe anxiety and be avoided entirely.[37]

35 National Taxpayer Advocate 2013 Annual Report to Congress 302.

36 *Id.*

37 Andrew M. Busch, Jonathan W. Kanter, Sara J. Landes, and Cristal E. Weeks, *The Nature of Clinical Depression: Symptoms, Syndromes, and Behavior Analysis*, Behav. Anal. 31(1): 1-21 (2008), *available at* http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2395346/ (stating that "[d]epression is characterized as much by increased escape and avoidance repertoires as by reduced positive repertoires"). As the fields of psychiatry and mental health have advanced, we have learned that some mental illnesses, such as PTSD, may bring about neurochemical changes in the brain which may have biological, psychological, and behavioral effects on an individual's health. *See* U.S. Department of Veterans Affairs, National Center for PTSD, *available at* http://www.ptsd.va.gov/professional/co-occurring/ptsd-physical-health.asp. *See also* Jonathan E. Sherin, MD, PhD and Charles B. Nemeroff, MD, PhD, *Post-Traumatic Stress Disorder: The Neurobiological Impact of Psychological Trauma*, Dialogues Clin. Neurosci. 2011 Sep; 13(3): 263-78.

EXPLANATION OF RECOMMENDATION

Add a Provision to IRC §§ 6343 and 6532(c) Requiring Tolling for Claims of Financially Disabled Taxpayers

The nine-month period in IRC §§ 6343(b) and 6532(c) has no tolling period for financially disabled taxpayers or third parties who are individuals.[38] Suspending the nine-month period in which a taxpayer or a third party who is an individual can request the IRS to return levy proceeds or to bring a civil action in courts would expand protections available to those taxpayers or third party individuals who are financially disabled, and make these protections consistent with the suspension of the statutory period of limitations in a refund context under IRC § 6511(h). The concerns that led Congress to enact IRC § 6511(h) are equally applicable to the requests for return of levy proceeds.[39]

Expand the Protections Available to Financially Disabled Individuals

As discussed in the National Taxpayer Advocate's 2013 Annual Report to Congress, taxpayers with disabilities often experience difficulty proving financial disability under IRC § 6511(h), due to its narrow definition of financial disability and medical professionals' ability to designate a taxpayer as financially disabled.[40] In brief, the IRS interpretation and guidance for what documentation the IRS can consider in evaluating a "qualified impairment" is unduly restrictive and may lead the IRS to dismiss otherwise compelling evidence, thereby resulting in the denial of relief to taxpayers who lacked the capacity to file a refund claim.[41] A better articulated exception with more breadth than the current definition will more readily protect individuals suffering from clinical depression, anxiety, PTSD, and other mental afflictions.[42] Therefore, Congress should adopt the National Taxpayer Advocate's 2013 recommendation to broaden the definition of financial disability under IRC § 6511(h) when defining financial disability for the purpose of tolling the statutory time period for filing under IRC §§ 6343 and 6532.

The National Taxpayer Advocate has previously submitted legislative recommendations to broaden relief from timeframes for filing a refund claim[43] and to extend the refund statute expiration date under IRC § 6511.[44] Even if Congress adopts the two years, the issue of tolling still exists, as it does with the three-year/two-year statutory limitations period for refund claims.[45] The National Taxpayer Advocate reaffirms these proposals and now recommends the nine-month period in which the IRS is authorized to return levy proceeds, or the court can hear a suit for return of levy proceeds, be suspended when the taxpayer is financially disabled.

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38 *See* 26 U.S.C. § 6343.

39 S. Rep. No. 105-174, at 60 (1998); H.R. Rep. No. 105-364, at 62 (1997).

40 National Taxpayer Advocate 2013 Annual Report to Congress 302-10.

41 National Taxpayer Advocate 2013 Annual Report to Congress 303. In *Kurko v. Commissioner*, Docket No. 24040-13L, a Collection Due Process hearing, the taxpayer argued that an amended return claiming an overpayment was timely because the time period for filing a claim was tolled under IRC § 6511(h). The taxpayer presented the Settlement Officer with a letter from a licensed psychologist stating that the taxpayer had a mental health disability that made her financially disabled for purposes of IRC § 6511(h)'s provision tolling the credit or refund claim period under (a). The Settlement Officer did not accept the letter from the licensed psychologist because Rev. Proc. 99-21, 1999-1 C.B. 960, required the letter to come from a doctor of medicine or osteopathy as defined in IRC § 1395x(r)(1). The taxpayer petitioned the United States Tax Court and in an order issued on March 20, 2015, Judge Gustafson instructed the parties to brief the issue of the validity of Rev. Proc. 99-21, 1999-1 C.B. 960. After reading Judge Gustafson's questions in his March 20 order, the IRS decided to sign a stipulated decision providing that the overpayment was timely claimed, notwithstanding that the letter was not from a "physician" – thereby settling the case and rendering the issue moot for purposes of the *Kurko* case.

42 *See* Rev. Proc. 99-21; T. Keith Fogg & Rachel E. Zuraw, *Financial Disability for All*, 62 Cath. U. L. Rev. 965, 994-1004 (2013).

43 National Taxpayer Advocate 2013 Annual Report to Congress 302.

44 National Taxpayer Advocate 2001 Annual Report to Congress 202.

45 *Id*. A bill was recently introduced in the United States Senate that included the National Taxpayer Advocate's recommendation and would extend the nine-month period in IRC § 6532(c) to two or three years. *See* S.1578, 114th Cong. (2015), S. 949, 114th Cong. (2015); H.R. 1828, 114th Cong. (2015).

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

TAXPAYER RIGHTS IMPACTED[1]

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

PROBLEM

By the early 1980's, Congress became concerned with the rapid growth of deliberate defiance of the tax laws by "tax protestors."[2] As a result, Congress passed Internal Revenue Code (IRC) § 6702, which, as currently formulated, generally imposes an immediately assessable $5,000 penalty on tax returns adopting a position which the IRS has identified as frivolous or reflecting a desire to delay or impede the administration of federal tax laws.[3] This penalty, however, 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.[4]

In order to mitigate the harshness of the frivolous return penalty, Congress also allowed for a reduction of the penalty, which now can be decreased from $5,000 to $500, if the IRS determines that such reduction would promote compliance with and administration of the federal tax laws.[5] Nevertheless, when adopting procedures implementing this provision, the IRS denied potential penalty reduction to any taxpayers to the extent they have already paid the penalty, including by means of an automatic or involuntary refund offset.[6] This broad exclusion is particularly problematic because no clearly defined procedures exist allowing an abatement of the penalty for reasonable cause and good faith.[7] Further, the IRS Office of Appeals (Appeals) refuses to consider any appeals of frivolous return penalties even if those appeals are contending that the penalties were incorrectly applied in the first instance or are in some other way substantively

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 S. Rep. No. 97-494(I), at 277 (1982). Subsequently, Congress enacted the IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle H, § 3707(a) (July 22, 1998), which prohibited the IRS from labeling taxpayers as Illegal Tax Protesters or adopting similar terminology based on fear of stigmatization. In RRA 98 § 3707(b), Congress, however, did allow IRS personnel to designate appropriate taxpayers as "nonfilers."

3 IRC § 6702(a)(2). The frivolous return penalty can also be imposed by the IRS in response to the filing of a specified frivolous submission. IRC § 6702(b). These IRC § 6702 penalties are sometimes also referred to as "postassessment penalties" because they can be assessed in the absence of deficiency procedures and because they do not provide prepayment review rights in the U.S. Tax Court. Internal Revenue Manual (IRM) 8.11.1.1.2(1) (Nov. 12, 2013).

4 S. Rep. No. 97-494(I), at 277 (1982).

5 IRC § 6702(d); Rev. Proc. 2012-43, 2012-49 I.R.B. 643. Taxpayers can also avoid assertion of the penalty if they withdraw a frivolous return within 30 days of receiving notice by the IRS. This right is statutory in the case of IRC § 6702(b), *Specified Frivolous Submissions*, and a matter of IRS policy in the case of IRC § 6702(a), *Frivolous Tax Returns*. *See* IRC § 6702(b)(3); IRM 4.10.12.1(10) (Sept. 5, 2014).

6 Rev. Proc. 2012-43, § 3, 2012-49 I.R.B. 643.

7 An abatement can be obtained if the IRS has asserted the penalty in error. IRM 25.25.10.8.4, *Post Penalty Assessment Processing* (Aug. 13, 2015).

erroneous.[8] Appeals may well be concerned with having to rehear arguments that gave rise to application of the frivolous return penalty in the first instance. However, mechanisms already exist that could be used and expanded to properly balance taxpayers' need for post-assessment, prepayment or post-payment appeal reviews with Appeals' legitimate need to address the proliferation of baseless claims.[9]

As options for relief have been narrowed by the IRS, opportunities for inappropriate application of the frivolous return penalty have been simultaneously increased. The number of frivolous positions specifically identified by the IRS has grown to over 50, some of which are sufficiently broad as to encompass unintentional tax reporting errors.[10] Further, as the IRS enlarges its reliance on automated systems for application of the frivolous return penalty, the likelihood of incorrect penalty application correspondingly will expand. Thus, an increasingly broad swath of taxpayers are exposed to application of the frivolous return penalty and are left with no meaningful administrative recourse.[11] The approach of the IRS, to shoot first and then not even ask or answer questions later, all too often results in application of the frivolous return penalty in a way that jeopardizes a range of fundamental taxpayer rights including *the right to challenge the IRS's position and be heard*, *the right to a fair and just tax system*, and *the right to appeal an IRS decision in an independent forum.*

EXAMPLE

Taxpayer earned $9,000 of adjusted gross income during the year and qualified for an Earned Income Tax Credit (EITC) of $3,600. When Taxpayer completed the tax return, however, Taxpayer made a clerical error, overreporting amounts withheld and claiming a refund of $9,000, rather than the $5,000 refund that was properly payable. The IRS issued a letter threatening Taxpayer with a frivolous return penalty if Taxpayer did not correct the return within 30 days. This letter frightened Taxpayer who decided to seek the assistance of a tax preparer. By the time a preparer could be located, however, and the return amended, the 30-day period had been exceeded by ten days, and the IRS moved forward with assessment of the $5,000 frivolous return penalty. This occurred despite Taxpayer's good faith effort to correct the clerical error.

Taxpayer was somewhat heartened when the tax preparer explained the penalty could be reduced from $5,000 to $500. This hope did not last long, however, as the IRS collected the full $5,000 penalty as an offset against the $5,000 refund to which Taxpayer was properly entitled. As a result, the IRS was unwilling to consider the request for a penalty reduction.[12] Taxpayer had been planning to use much of the claimed refund for essential living expenses, but after offset of the full frivolous return penalty, Taxpayer was left with nothing.

With the assistance of the tax preparer, Taxpayer filed an abatement request arguing that the error was made in good faith, which was summarily denied based on the cryptic explanation that the IRS would only look at the face of the return in determining application of the frivolous return penalty. Not

8 Appeals previously undertook such reviews but has recently modified its policy in this regard. *Compare* IRM 8.11.8.2(1) (Oct. 28, 2013) with obsolete IRM 8.11.1.7(3) (Feb. 26, 1999).

9 *See, e.g.*, IRM 8.22.5.5.3.1, *Processing Frivolous, Desire to Delay or Impede Requests* (Nov. 8, 2013).

10 These positions identified by the IRS as frivolous are set forth in Notice 2010-33, 2010-17 I.R.B. 609, as supplemented by IRM 4.10.12.1.1, *Frivolous Arguments* (Sept. 5, 2014).

11 Taxpayers theoretically can pay the penalty and file a refund claim in Federal District Court, but such a remedy generally would cost taxpayers more than the underlying penalty and would be particularly burdensome for low income and unsophisticated taxpayers.

12 *See* Rev. Proc. 2012-43, 2012-49 I.R.B. 643.

believing this answer could be correct, Taxpayer sought to have the matter reviewed by Appeals. Taxpayer, however, was informed Appeals no longer heard any challenges to the frivolous return penalty. Taxpayer was told about the possibility of filing a refund claim in federal court, but Taxpayer no longer had either the funds or energy to pursue the matter further.

RECOMMENDATIONS

In order to protect good faith taxpayers and enable the frivolous return penalty to be imposed more fairly and effectively, the National Taxpayer Advocate recommends that Congress:

1. 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).
2. Amend IRC § 6702(d) to clarify taxpayers will be eligible for reduction of the frivolous return penalty regardless of whether they have already satisfied the penalty.
3. Amend IRC § 6702 to establish the availability of a full penalty abatement for good faith and reasonable cause.
4. Amend IRC § 6702 to provide that taxpayers will be entitled to obtain either a post-assessment, prepayment or post-assessment, post-payment review of frivolous return penalties within Appeals.

PRESENT LAW

IRC § 6702 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.[13] Further requirements for application of the frivolous return penalty are that a taxpayer has filed what purports to be a tax return that does not contain information on which the substantial correctness of the self-assessment may be judged or that contains information that on its face indicates the self-assessment is substantially incorrect.[14] The frivolous return penalty can also be imposed by the IRS in response to the filing of specified frivolous submissions, which include collection due process (CDP) appeals, requests for installment agreements, proposed offers in compromise, and taxpayer assistance orders.[15]

The IRS first identified frivolous positions subject to the IRC § 6702 penalty in Notice 2007-30.[16] This list was augmented in 2008, and then again in 2010 when the group was expanded to cover over 50 positions and any others that were the same as or similar to those positions.[17]

This list of frivolous positions was provided at the express direction of Congress.[18] Nevertheless, Congress also envisioned certain parameters limiting application of the frivolous return penalty. Congress wanted a regime that discouraged "protest" returns, but not one that adopted punitive measures with respect to potentially good faith taxpayers. As a result, Congress also required the IRS to provide taxpayers individual notice that a position they adopted constitutes a specified frivolous submission and furnish the

13 IRC § 6702(a)(2).
14 IRC § 6702(a)(1).
15 IRC § 6702(b).
16 Notice 2007-30, 2007-14 I.R.B. 883.
17 Notice 2008-14, 2008-4 I.R.B. 310; Notice 2010-33, 2010-17 I.R.B. 609.
18 IRC § 6702(c).

opportunity to avoid application of the penalty if the position is withdrawn within 30 days.[19] The IRS now issues these 30-day letters in the case of potential IRC § 6702(a) penalties as well as those arising under IRC § 6702(b).[20]

As Congress originally explained,

> The committee believes that an immediately assessable penalty on the filing of protest returns will help deter the filing of such returns, and will demonstrate the determination of the congress to maintain the integrity of the income tax system …. The penalty will be imposed, therefore, only on purported returns that are patently improper and not in cases involving valid disputes with the Secretary. This penalty will not be imposed, of course, in the case of innocent or inadvertent mathematical or clerical errors (as defined in § 6213(G)(2)(A) or (B)), including certain incorrect uses of tax tables, etc.[21]

Congress also provided the statutory authority for the IRS to reduce the IRC § 6702 penalty "… if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws."[22] When establishing the procedures for this reduction in Rev. Proc. 2012-43, however, the IRS imposed some significant limitations. Among other things, the IRS determined that it would only reduce a frivolous return penalty from $5,000 to $500.[23] Further, this reduction would only be available to the extent that the penalty had not already been satisfied by the taxpayer.[24]

A taxpayer has no appeal rights if the IRS rejects a reduction request.[25] Further, Appeals does not currently consider any challenges with respect to application of the IRC § 6702 penalty.[26]

REASONS FOR CHANGE

The National Taxpayer Advocate applauds both Congress and the IRS, respectively, for allowing taxpayers to avoid application of the frivolous return penalty if they withdraw and correct their frivolous position within 30 days of receiving notice from the IRS.[27] This approach allows taxpayers to self-correct unintentional errors without experiencing the stigma and the burden of the frivolous return penalty. It has the additional benefit of using IRC § 6702 as an opportunity to educate taxpayers and encourage their future compliance.[28]

TAS is aware of a number of circumstances, however, in which taxpayers, despite diligent and good faith efforts, have simply been unable to withdraw and correct their erroneous returns within the 30-day notice period. This challenge is particularly acute for unsophisticated taxpayers who may require the assistance of a tax preparer to amend their tax return or even to understand the contents of the notice letter itself.[29]

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19 IRC § 6702(b)(3).

20 IRM 4.10.12.1(10) (Sept. 5, 2014).

21 S. Rep. No. 97-494(I), at 277 (1982).

22 IRC § 6702(d).

23 Rev. Proc. 2012–43, § 4.01(2), 2012-49 I.R.B. 643.

24 Rev. Proc. 2012–43, § 3, 2012-49 IRB (Dec. 3, 2012).

25 *See* Rev. Proc. 2012-43, § 5.03, 2012-49 IRB (Dec. 3, 2012).

26 *See* IRM 8.11.8.2(1) (Oct. 28, 2013).

27 This 30-day window is statutory in the case of IRC § 6702(b) and a matter of IRS policy in the case of IRC § 6702(a). *See* IRC § 6702(b)(3); IRM 4.10.12.1(10) (Sept. 5, 2014).

28 IRM 20.1.1.2.1(8) (Nov. 25, 2011).

29 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163 and 172.

The notice's effectiveness should not be limited by application of a response window that is simply too short for many taxpayers, especially some unsophisticated taxpayers. As a result, the National Taxpayer Advocate recommends that Congress consider statutorily expanding the notice period allowing taxpayers to correct their returns and avoid application of the frivolous return penalty from 30 days to a reasonable but more manageable 60 days, which is in line with the amount of time available to taxpayers to correct summary assessments under IRC § 6213(b)(2), *Abatement of assessment of mathematical or clerical errors.*

Further, the previous addition by Congress of IRC § 6702(d) allowing for a reduction of the frivolous return penalty, is laudable. Nevertheless, the IRS is currently applying that reduction in a way that does not comport with Congress' intent and sometimes appears to be arbitrary and capricious.

TAS has received requests for assistance from taxpayers in a number of cases in which a group of taxpayers has been taken in by an unscrupulous tax preparer and all adopted the identical frivolous return position. Nevertheless, some of those taxpayers are eligible for the IRC § 6702(d) reduction while others are not. This distinction is often based solely on whether or not the taxpayers have already satisfied, either through direct payment or refund offset, the $5,000 penalty initially asserted by the IRS.[30]

Those taxpayers who have satisfied the $5,000 penalty are essentially double-penalized for their willingness to pay, or for their overpayment status, by losing eligibility for the reduction to $500. This practice by the IRS not only violates most taxpayers' notions of fairness, but is particularly hard on taxpayers who rely on certain refundable credits, such as the EITC. When these anticipated refunds fail to arrive, such taxpayers often find themselves in desperate circumstances without the money they had counted on for basic living expenses.

There is no persuasive reason to differentiate between taxpayers based on the payment status of the original penalty, and a very good reason to make application of the reduction more equitable. Voluntary compliance tends to correlate with taxpayers' perceptions that the IRS and the tax laws are fair and may decline if taxpayers feel that the IRS is overreaching or applying arbitrary rules.[31] Thus, Congress should consider taking steps to require that the IRS abandon the distinction that it currently draws between those who have and have not satisfied the penalty when considering eligibility for the IRC § 6702(d) penalty reduction.

Further, the IRS applies the IRC § 6702 penalty in a highly mechanical fashion, and this process is being increasingly automated. Thus, it is quite possible for taxpayers to be erroneously assessed the penalty in the first instance or for good faith taxpayers to file a return that is technically frivolous without ever intending to do so.

For example, Notice 2010-33 identifies as a frivolous position the assertion of the Fifth Amendment right against self-incrimination as the basis for withholding "all financial information from the Service."[32] When a taxpayer asserted this right with respect to the omission of certain information from the interest and dividend schedule on his tax return, the IRS assessed the IRC § 6702 penalty, and, after relief was denied in a CDP appeal, the matter came before the U.S. Tax Court in the form of cross-motions for summary judgment.[33] Judge Holmes granted the taxpayer's motion for summary judgment on the grounds that because the withheld information related to the duty to file a *Report of Foreign Bank and Financial*

30 Note: these refund offsets generally are automatic and involuntary.

31 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 134.

32 Notice 2010-33, § III.(9)(f), 2010-17 I.R.B. 609.

33 *Youssefzadeh v. Comm'r*, No. 14868-14 L. (Nov. 6, 2015).

Accounts (FBAR), and because the willful failure to file an FBAR is a crime, the Fifth Amendment had been properly invoked, and the assessed IRC § 6702 penalty was therefore invalid. The frivolous return penalty should not be used by the IRS as a means of doing an end run around Constitutional protections or other legitimately exercised rights.

Some taxpayers have been successful in persuading the IRS to abate the IRC § 6702 penalty where it was incorrectly applied or where it resulted from a position that the taxpayers did not know to be improper.[34] Nevertheless, TAS is also aware of other occasions in which similarly situated taxpayers have been treated differently and subjected to the penalty. The IRS is not always consistent in its standards for acknowledging and utilizing its discretion to abate the frivolous return penalty under IRC §§ 7803 and 6404.[35]

The IRS frequently assumes that anyone caught up in the ever-expanding definition of a frivolous return must, by default, be a bad actor. However, this category now includes many taxpayers who had no desire to delay or impede the administration of federal tax laws. As the IRS itself recognizes in *The Penalty Handbook*, "Voluntary compliance is achieved when a taxpayer makes a good faith effort to meet the tax obligations defined by the Internal Revenue Code."[36] Penalties should be objectively proportioned to the offense, and be used as an opportunity to educate taxpayers and encourage their future compliance.[37] Penalties should relate to the standards of behavior they encourage.[38] IRS employees are responsible for administering the penalty statutes and regulations in an even-handed manner that is fair and impartial to both the government and the taxpayer.[39]

Such balance, however, is absent where provision of frivolous return abatements is concerned. Additional clarity and uniformity in this area would benefit both taxpayers and the government. Several IRC provisions expressly allow a penalty abatement for reasonable cause and good faith.[40] Congress should consider amending IRC § 6702 to clarify the specific availability of such an abatement in appropriate cases where application of the frivolous return penalty is concerned. Congress has already demonstrated its support for this approach in the legislative history quoted above. This step would help eliminate confusion within the IRS and on the part of taxpayers regarding abatement discretion and would perpetuate fairness and consistency in application of the frivolous return penalty.

The problems inherent in overly broad application of the penalty are exacerbated by Appeals' current unwillingness to review IRC § 6702 determinations.[41] Appeals has the authority to review such cases, but has made the "business decision" to terminate the provision of such oversight.[42] This policy effectively eliminates any higher level administrative review of the actions taken by the IRS's Frivolous Return

34 *See* IRM 25.25.10.8.4, *Post Penalty Assessment Processing* (Aug. 13, 2015).

35 IRC § 7803 abatements are premised on the IRS Commissioner's general authority to administer the IRC. *See also* IRC § 6404; IRM 25.6.1.10.1.1(2) (Nov. 18, 2011). This general abatement authority can result in a refund to the extent that the refund statute of limitations under IRC § 6511 remains open with respect to any previously paid assessments that are the subject of the abatement. IRM 25.6.1.10.1.1(6) (Nov. 18, 2011).

36 IRM 20.1.1.2.1(6) (Nov. 25, 2011).

37 IRM 20.1.1.2.1(8) (Nov. 25, 2011).

38 IRM 20.1.1.2.1(10) (Nov. 25, 2011).

39 IRM 20.1.1.2.2(c) (Nov. 25, 2011).

40 *See, e.g.*, IRC §§ 6662(c), 6651(a), and 6038D.

41 The importance of appeal rights and other issues currently relating to Appeals are further developed in the National Taxpayer Advocate 2015 Annual Report to Congress, Most Serious Problem: *Appeals: The Appeals Judicial Approach and Culture Project is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*, *supra*.

42 IRS Office of Chief Counsel Memorandum, *Appeals Rights with Respect to a Request to Abate a Section 6702 Penalty*, PMTA 2013-28 (Dec. 20, 2013).

Program (FRP).[43] It is also inconsistent with the IRS's adoption of the Taxpayer Bill of Rights, particularly *the right to appeal an IRS decision in an independent forum* and *the right to challenge the IRS's position and be heard.*

Taxpayers are granted the option of paying the assessed penalty and seeking a refund in Federal District Court. Realistically, however, very few taxpayers, particularly lower income taxpayers, will possess the financial resources or the remaining energy to continue fighting a $500 penalty, or even a $5,000 penalty, in federal court. Further, in most cases, the legal expenses and other related costs required to contest the penalty would exceed the amount of the penalty itself. The deprivation of appeal rights in the case of IRC § 6702 frivolous return penalties is a punitive and unnecessary denial of fundamental taxpayer rights that Congress should consider taking steps to rectify by allowing for an independent Appeals review regardless of whether the immediately assessable penalty has yet been paid by taxpayers.

Appeals may well be concerned with having to rehear arguments that gave rise to application of the frivolous return penalty in the first instance. Nevertheless, Appeals already has procedures directing Appeals personnel to ignore frivolous arguments raised as part of various proceedings, such as CDP appeals.[44] Such an approach applied to all appeals of frivolous return penalties presumably would discourage repetition of these arguments and should address case proliferation concerns. Moreover, such potential administrative burdens should not serve as the basis for denying taxpayers basic access to Appeals.

TAS has held ongoing discussions with the IRS operating divisions regarding many of these issues for years. Nevertheless, no significant administrative progress has been made toward implementing these recommendations for protecting taxpayer rights and thereby increasing the effective and equitable application of IRC § 6702.

EXPLANATION OF RECOMMENDATION

Over time, the reach of the IRC § 6702 frivolous return penalty has extended beyond the bad actors for whom it was originally designed. Additionally, the IRS's approach to applying the penalty and the related reduction has confused and harmed many good faith taxpayers. The recommendations, which seek to balance the concern for administrative efficiency with the need for taxpayer protections, would allow taxpayers a broader window for correcting returns and submissions identified as frivolous, would achieve greater uniformity in application of the IRC § 6702(d) reduction, would allow for a reasonable cause abatement of the full amount of the penalty in the case of good faith taxpayers, and would ensure that taxpayers are entitled to obtain review of frivolous return penalty abatement requests by Appeals.

43 The FRP currently resides within the Wage & Investment Division of the IRS.

44 IRM 8.22.5.5.3.1, *Processing Frivolous, Desire to Delay or Impede Requests* (Nov. 8, 2013).

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

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*

PROBLEM

The IRS relies on new information returns 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 (ALEs)[2] to file information returns with the IRS reflecting specific information regarding health insurance coverage,[3] the law does not permit these companies to verify taxpayer identification numbers (TINs) with the IRS prior to filing.[4] Unlike other information return filers who can perfect TINs prior to issuing any information reporting forms if 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.[5] If these entities were able to verify name/TIN accuracy prior to filing these information reports, they would avoid unnecessary penalties and the IRS would minimize the resources spent on avoidable penalty abatement requests.

EXAMPLE

ABC Health is a health insurance provider that insures 800,000 individuals in the state of Maryland. As part of the insurance enrollment process, ABC Health obtains TINs from insured individuals that it uses to prepare approximately 600,000 Forms 1095-B (and the associated transmittal Form 1094-C).[6] ABC Health timely files the forms with the IRS and provides copies to the insured. Upon filing, the IRS finds that 10,000 of the TINs do not match the insureds' names, whether due to transposition errors, name changes, or otherwise. As a result, ABC Health faces $2.5 million in penalties. If ABC Health also includes the incorrect TINs on statements it furnishes to the insured, it could potentially be liable for

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Internal Revenue Code (IRC) § 4980H(a)(1) provides that an ALE must offer minimum essential coverage (MEC) to its full-time employees. In general, an employer is considered an ALE if it employs 50 or more full-time workers (or full-time equivalents (FTEs)), or a combination of full-time and part-time employees that equals at least 50 FTEs. IRC § 4980H(c)(2).

3 IRC §§ 6055 and 6056.

4 In the case of an individual taxpayer, a TIN generally is the Social Security number (SSN). *See* IRC § 6109(d). The IRS may also issue an adoption taxpayer identification number (ATIN). For an alien individual not eligible for an SSN who has a federal tax reporting requirement, the IRS assigns an individual taxpayer identification number (ITIN). *See* Treas. Reg. § 1.6109-1(a) and (d).

5 IRS response to TAS information request (Oct. 22, 2015).

6 A health insurer needs to provide a Form 1095-B to each responsible person (the individual who is the primary insured) that will include the information for all other individuals covered under that responsible person. IRC § 6055. The total number of Forms 1095-B will be less than the total number of covered individuals when taking into account self plus one and family plans.

an additional $2.5 million in penalties. If the errors were due to intentional disregard of the filing and furnishing requirements, the potential penalties would be much greater.

RECOMMENDATION

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.

PRESENT LAW

IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. IRC § 6056 requires annual information reporting by ALEs relating to the health insurance that the employer offers (or does not offer) to its full-time employees. Below is a list of information returns the IRS created to meet these reporting requirements:

- Form 1095-B, *Health Coverage* (used by health insurance issuers and carriers to report information about individuals who are covered by MEC);[7]
- Form 1094-B, *Transmittal of Health Coverage* (used by health insurance issuers and carriers to submit Form 1095-B);
- Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage Insurance* (used by ALEs to report information about offers of health coverage and actual coverage of full-time employees);[8] and
- Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns* (used by ALEs to submit Form 1095-C).

Form 1095-B was developed to verify compliance with the requirement to have MEC under IRC § 5000A. The form reports the names and TINs of all individuals covered under a health insurance plan and the months of coverage.[9] If the IRS cannot verify that a taxpayer had MEC, the taxpayer will be assessed an Individual Shared Responsibility Payment (ISRP).[10]

7 The forms are due by February 28 (or March 31 if filing electronically). IRS, *Instructions for Forms 1094-B and 1095-B* (2015), *available at* www.irs.gov/pub/irs-pdf/i109495b.pdf.

8 The forms *are due by February 28 (or March 31 if filing electronically). IRS, Instructions for Forms 1094-C and 1095-C (2015), available* at www.irs.gov/pub/irs-pdf/i109495c.pdf.

9 If an insurer is unable to obtain a TIN for an individual after making a reasonable effort, the regulations allow it to provide the individual's date of birth instead of the TIN.

10 IRC § 5000A. Taxpayers filing tax year 2014 federal income tax returns were required to report they have MEC or were exempt from the responsibility to have the required coverage. If the taxpayer did not have coverage and was not exempt, he or she was required to make an ISRP when filing a return. For a detailed discussion of the ISRP, see *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, supra*.

Form 1095-C was developed to determine whether an ALE will be subject to an Employer Shared Responsibility Payment (ESRP) for failure to offer affordable MEC to its full-time employees.[11] The form reports the names and TINs of all full-time employees, as well as information about their coverage under the employer-provided plan, their offer of coverage, and share of the insurance premium. This information will also be used to verify a taxpayer's eligibility for the Premium Tax Credit (PTC) if he or she claimed one on his or her tax return.[12]

FIGURE 2.9.1, Projected Volume of Information Returns for ACA Exchange Provisions, Tax Years 2015–2017[13]

	Tax Year 2015	Tax Year 2016	Tax Year 2017
Forms 1095-B	46 million	45 million	47 million
Forms 1095-C	77 million	77 million	78 million
Total	**123 million**	**122 million**	**125 million**

As noted above, the IRS expects to receive over 120 million information returns from health insurance providers and ALEs during the 2016 filing season. These information returns facilitate the administration of the ESRP, establish health insurance coverage — or lack thereof — for the ISRP, and impact eligibility for the PTC and Small Business Health Care Tax Credit (SBHCTC).[14]

The penalty for failure to file a correct information return is generally $250, and the penalty for failure to furnish a correct payee statement is also generally $250.[15] Each penalty is capped at $3 million for each calendar year. If the failure is due to intentional disregard of the filing or furnishing requirements, the penalty for each return or statement would be at least $500, with no maximum. IRC § 6724 provides that the IRS will not impose the penalty if the filer shows the failure was due to reasonable cause and

11 IRC § 4980H provides that an ALE will be subject to an ESRP if (1) it fails to offer its full-time employees the opportunity to enroll in MEC under an eligible employer-sponsored plan, and (2) a PTC was paid to at least one full-time employee. The amount of the ESRP under IRC § 4980H(a) is $2,000 per full-time employee per year (determined on a monthly basis). IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5). IRC § 4980H(b) requires ALEs to offer affordable MEC that provide minimum value. If an ALE offers MEC but it is not considered affordable, the ALE will be assessed an ESRP of $3,000 for each employee (pro-rated on a monthly basis) who purchases health insurance from the exchange and is granted a tax credit and/or subsidy for health insurance. IRS § 4980H(b)(1). While an employer may be subject to ESRP under both IRC § 4980H(a) and (b), the liability is limited to the amount under IRC § 4980H(a). Treas. Reg. § 54-4890H, 79 Fed. Reg. 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

12 PTC is a refundable tax credit paid either in advance or at return filing to help taxpayers with low to moderate income purchase health insurance through the exchange. IRC § 36B. The amount of the credit paid in advance is based on projected household income (HHI) and family size for the year of coverage, while the amount a taxpayer is actually eligible for is based on actual HHI and family size for the year reflected on the tax return. Many taxpayers were required to reconcile the credit amount they received in advance with the PTC to which they were actually entitled. For a detailed discussion of the PTC, see 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, supra*.

13 IRS response to TAS information request (Oct. 22, 2015).

14 Under IRC § 45R, eligible small employers can claim the SBHCTC for 2010 through 2013 and for two additional years beginning in 2014. A small employer is eligible for the credit if (a) it has fewer than 25 FTE employees, (b) the average annual wages of its employees are less than $50,000 (adjusted for inflation beginning in 2014), and (c) it pays a uniform percentage for all employees that is equal to at least 50 percent of the premium cost of employee-only insurance coverage. For a detailed discussion of the SBHCTC, see *Affordable Care Act (ACA) - Business: The IRS Faces Challenges in Implementing the Employer Provisions of the Affordable Care Act While Protecting Taxpayer Rights and Minimizing Burden*, *supra*.

15 *See* IRC §§ 6721 and 6722. The penalty amounts are an increase over the previous penalty amount of $100 and apply to information returns filed after December 31, 2015. The penalty amounts are also indexed for inflation.

not willful neglect.[16] If a health insurance company or ALE reports an incorrect TIN on Form 1095-B or 1095-C due to inaccurate input from their customer or employee, the provider may obtain a penalty waiver upon proving reasonable cause. The health insurance company or ALE must establish that the failure to include a correct TIN was due to events beyond its control and that it acted in a responsible manner by soliciting a TIN from the customer or employee in accordance with specific solicitation rules set forth in regulations.[17]

The IRS will not impose penalties under IRC §§ 6721 and 6722 for 2015 information returns on reporting entities that can show that they have made good faith efforts to comply with the information reporting requirements. Specifically, relief is provided from penalties for incorrect or incomplete information reported on the return or statement. No relief is provided for reporting entities that cannot show a good faith effort to comply with the information reporting requirements or that fail to timely file an information return or furnish a statement.[18]

Under IRC § 3406(i), the Commissioner has the authority to establish TIN matching programs for information returns that report payments subject to backup withholding, such as dividends or other income. Under such a TIN matching program, a payor with reportable payments as defined in IRC § 3406(b)(1) may contact the IRS prior to filing information returns.[19] The IRS will inform the payor (or an agent of the payor) whether or not a name/TIN combination furnished by the payee matches a name/TIN combination maintained in the database utilized for the particular matching program, which will help participating payors avoid TIN errors and reduce the number of backup withholding notices required under IRC § 3406(a)(1)(B).

The IRS online interactive or bulk TIN matching program is accessible 24 hours a day, seven days a week.[20] The IRS response is generally limited to notification of a match or mismatch.[21] If the IRS response indicates a TIN mismatch, the payor has the opportunity to resolve the inaccuracy with the payee, prior to filing an information return. Otherwise, the IRS generally may not disclose a taxpayer's name, TIN, or other return information, pursuant to IRC § 6103.[22]

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16 *See* IRC § 6724(a).

17 *See* Treas. Reg. § 301.6724-1(c)(6) and (d)(2).

18 IRS, *Questions and Answers on Information Reporting by Health Coverage Providers (Section 6055)*, Question 3, *available at* https://www.irs.gov/Affordable-Care-Act/Questions-and-Answers-on-Information-Reporting-by-Health-Coverage-Providers-Section-6055 (last visited Nov. 23, 2015). However, consistent with the existing information reporting rules, reporting entities that fail to timely meet the requirements still may be eligible for penalty relief if the IRS determines that the standards for reasonable cause under IRC § 6724 are satisfied.

19 *See* Treas. Reg. § 31.3406(j)-1; Rev. Proc. 2003-9, 2003-8 I.R.B. 516.

20 *See* IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program*.

21 The TIN Matching Program provides a numerical response indicator for each match request. The potential responses include: '0' - Name/TIN combination matches IRS records; '1' - Missing TIN or TIN not nine-digit numeric; '2' - TIN not currently issued; '3' - Name/TIN combination does NOT match IRS records; '4' - Invalid request (*i.e.*, contains alphas, special characters); '5' - Duplicate request; '6' - (Matched on SSN), when the TIN type is (3), unknown, and a matching TIN and name control is found only on the NAP DM1 database; '7' - (Matched on EIN), when the TIN type is (3), unknown, and a matching TIN and name control is found only on the EIN N/C database; '8' - (Matched on SSN and EIN), when the TIN type is (3), unknown, and a matching TIN and name control is found on both the NAP DM1 and the EIN N/C databases. IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program* § 14, FAQ 9 at 9.

22 *See* IRC § 6103. *See also* National Taxpayer Advocate 2003 Annual Report to Congress 232 (Legislative Recommendation: *Confidentiality and Disclosure of Returns and Return Information*). Third-party payors and their authorized agents who participate in the TIN Matching Program must sign an online Terms of Agreement (TOA) clause stating they will attempt to match name/TIN combinations only for the types of reportable payments listed in Rev. Proc. 2003-9. IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program* § 4.3 at 4.

REASONS FOR CHANGE

Currently, IRC § 3406 authorizes the IRS TIN matching program only for payors of reportable payments subject to backup withholding. Currently, that is the only statutory authorization for TIN matching; the IRS is precluded under IRC § 6103 from disclosing information to filers of returns not subject to backup withholding. The filers of other information returns that are not subject to backup withholding have no ability to verify the accuracy of the information provided to the IRS, yet are subject to the same penalties for failure to file an accurate information return as those who have access to TIN matching. Because these filers do not have access to TIN matching, they may file information returns with incorrect name/TIN combinations and receive penalty notices, and will have to prove reasonable cause to abate penalties imposed, thereby increasing taxpayer burden and IRS rework.

In 2013, the National Taxpayer Advocate included a legislative recommendation to expand TIN matching to colleges and universities to reduce burden on all parties involved.[23] Similarly, a legislative change that would allow filers required to file information returns under IRC §§ 6055 and 6056 to use TIN matching to verify TINs with the IRS prior to filing annual information returns would benefit the IRS, employers, health insurance providers, and taxpayers by facilitating accurate information returns.

While information matching is a critical part of the IRS's compliance strategy, it is only as effective as the accuracy of the data provided.[24] Health insurance companies and ALEs have an information reporting requirement for which they need to verify TINs.[25] TINs may not match an individual's name for various reasons, such as transposition errors or name changes. The IRS's inability to accurately match a taxpayer against a Form 1095-B or 1095-C will place him or her at risk for receiving notices from the IRS that he or she is liable for an ISRP. Still, other taxpayers may have their PTC claims questioned. Furthermore, ALEs may unnecessarily be required to substantiate coverage to employees if the data is unreliable or in error. 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. This increased burden can be avoided if Congress expands TIN matching beyond the currently authorized program to allow these filers to verify name/TIN combinations and learn of inaccuracies prior to filing information returns. This recommendation benefits the IRS, information return filers, and taxpayers by facilitating accurate information returns.

EXPLANATION OF RECOMMENDATION

ACA was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, the ACA provides targeted tax credits for low income individuals and small businesses while imposing a personal responsibility on individuals to have health coverage.[26] 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, required by IRC §§ 6055

23 *See* National Taxpayer Advocate 2013 Annual Report to Congress 319-21 (Legislative Recommendation: *Tuition Reporting: Allow TIN Matching By Colleges*).

24 *See* National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 83 (calling for improved accuracy of third-party reporting data); National Taxpayer Advocate 2011 Annual Report to Congress 82 (questioning the accuracy of third-party data as a source for math error adjustments).

25 Many of these filers may already have access to TIN matching for other information returns they are required to file.

26 IRC § 4980H(a)(1) imposes a responsibility for ALEs to offer health care to employees in certain circumstances. ACA, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010); S. Fin. Comm., 111th Cong., Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans (May 14, 2009), *available at* http://finance.senate.gov/download/?id=1DD95955-E95D-4AC7-919D-DAA62490D249.

and 6056, which include information that helps facilitate accurate administration of the law. The ACA contains a number of new provisions, and 2016 marks the first year applicable entities will have to file these information returns. If the information provided is inaccurate, taxpayers and employers could be assessed penalties, the IRS will have to work through avoidable penalty abatement requests, audits, and amended returns — all of which impacts taxpayers' *right to pay no more than the correct amount of tax*.

The TIN matching process reduces errors in information reported, resulting in fewer inaccurate IRS notices and penalties, saving both taxpayer and IRS resources. As a result, both the Information Reporting Program Advisory Committee (IRPAC)[27] and practitioners have called for an expansion of the TIN matching program to filers of Forms 1095-B and 1095-C.[28] The IRS has already announced penalty relief for 2015 forms filed in 2016, recognizing that entities will face difficulty with compliance amid potential issues. By extending TIN matching to Forms 1095-B and 1095-C, the recommendation reduces unnecessary burden and work for health insurance companies, ALEs, the IRS, and taxpayers.

27 IRPAC is a federal advisory committee whose primary purpose is to provide a public forum for the IRS and members of the information reporting community in the private sector to discuss relevant information reporting issues.

28 IRPAC, *2014 Information Reporting Program Advisory Committee (IRPAC) Public Report*, 19-22, *available at* https://www.irs.gov/pub/irs-utl/2014%20Public%20Report%20Final.pdf; Treas. Reg. §§ 1.6055-1 and 1.6055-2 (summary of comments), available at http://www.gpo.gov/fdsys/pkg/FR-2014-03-10/pdf/2014-05051.pdf; Michael M. Lloyd & S. Michael Chittenden, *Expand TIN Matching Program to Avert Another ACA Debacle*, Tax Notes 424-28 (Jan. 27, 2014).

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

TAXPAYER RIGHTS IMPACTED[1]

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

PROBLEM

The IRS's Tax Exempt and Government Entities (TE/GE) division maintains a list of tax exempt organizations (EOs) on two publicly accessible online databases, the Exempt Organizations Business Master File (EO BMF)[2] and Exempt Organizations Select Check (EO Select Check).[3] When an EO fails to file an information return or notice for three consecutive years, its exempt status is automatically revoked.[4] Shortly after this automatic revocation, which can sometimes be erroneous, the IRS removes the EO from its online-published lists of EOs and lists it as one whose exempt status was automatically revoked.

Unless the automatic revocation was due to IRS error, an automatically revoked organization must submit a new application to have its exempt status reinstated.[5] Even if the IRS promptly reinstates the organization or discovers its error, IRS databases will not immediately reflect the organization's restored exempt status, as the IRS updates its databases only monthly, on the second Monday of every month. However, these databases are not updated at all during the month of January, meaning there is a two-month updating gap from the second Monday in December until the second Monday in February.[6] 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. The number of automatic revocation reinstatement cases during this gap period alone exceeded 2,500 in both fiscal years (FYs) 2014 and 2015, and more than 70 percent of these cases were 501(c)(3) organizations.[7] These delays undermine taxpayers' *right to be informed* and *right to quality service*.[8]

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The EO BMF (http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Business-Master-File-Extract-EO-BMF) contains information about EOs such as the organization's employer identification number (EIN), name and address, the Internal Revenue Code (IRC) § 501(c) subsection under which it is exempt, whether contributions to it are tax deductible, whether it is a private foundation or a public charity (and the type of public charity), the month and year it received its exemption ruling, and information from its Form 990 series return. *See* Exempt Organizations Business Master File Extract (EO BMF), *available at* http://www.irs.gov/pub/irs-soi/eo_info.pdf.

3 EO Select Check is an online search tool, *available at* http://apps.irs.gov/app/eos/, that allows users to search for organizations eligible to receive tax deductible contributions (Publication 78 data), organizations whose tax exemption has been automatically revoked for not filing a Form 990-series return or notice for three consecutive years (Auto-Revocation List), and organizations that have filed a Form 990-N (also called an e-Postcard), an annual notice required to be filed by small EOs. Unless otherwise indicated, we use "EO Select Check" to refer to the capability to determine whether an organization is eligible to receive tax deductible contributions (Publication 78 data). *See* Internal Revenue Manual (IRM) 25.7.6.1 (Jan. 1, 2015).

4 *See* IRC § 6033(j)(1) (requiring the IRS to publish and maintain a list of automatically revoked organizations).

5 *See* IRC § 6033(j)(2).

6 *See* IRM 25.7.5.1(1) (Jan. 1, 2015) (noting that the EO Standard Extract Program is a computer program that is run on a monthly basis (except for January) to allow for extraction of both entity and limited return information from EO accounts contained on the BMF).

7 TE/GE response to TAS research request (July 31, 2015).

8 For a detailed discussion of the EO database updating delay issue, see Most Serious Problem: *Exempt Organizations (EOs): The IRS's Delay in Updating Publicly Available Lists of EOs Harms Reinstated Organizations and Misleads Taxpayers*, *supra*.

EXAMPLE

A small, volunteer-run Internal Revenue Code (IRC) § 501(c)(3) EO is automatically revoked because it did not file a required information return or notice for three consecutive years.[9] As a result, the IRS places the organization on the automatic revocation list and removes it from the EO BMF and EO Select Check online databases.

Once the organization discovers that its exemption was automatically revoked, it quickly applies for reinstatement of exempt status. The IRS promptly approves the application and sends the organization a new determination letter acknowledging the approval. However, this approval occurs in mid-December, after the IRS has already updated its online databases and the next update will not occur until February. The organization is contacted by a potential donor who would like to make a sizeable donation before the end of the year but wishes to confirm the organization's exempt status beforehand to ensure the donation will be tax-deductible. The potential donor is concerned because although the organization has a new determination letter, its name does not appear on the IRS's online databases. As a result, the organization may lose a critical donation because the IRS's online databases do not accurately reflect its exempt status.

RECOMMENDATIONS

To address IRS delays in updating its publicly available databases of EOs and their adverse impact on automatically revoked organizations that have been reinstated, the National Taxpayer Advocate recommends that Congress amend IRC § 6033 to require the IRS to:

1. Update EO BMF and Select Check on a weekly basis as is the case for Form 990-N updates; and
2. 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.

PRESENT LAW

Almost ten years ago, Congress passed the Pension Protection Act of 2006, which among other things, amended IRC § 6033 to provide for the automatic revocation of EOs that did not file a required information return or notice for three consecutive years.[10] Once an organization is automatically revoked, the IRS is required by statute to place it on a list of automatically revoked organizations.[11] Automatically revoked organizations seeking reinstatement of exempt status are also statutorily required to submit a new application to the IRS (except for when the revocation was erroneous).[12]

In addition to being placed on the automatic revocation list, organizations that have been automatically revoked are removed from the two online databases of EOs, EO BMF and EO Select Check. These databases are of critical importance for two reasons. First, they allow potential individual donors to verify,

9 *See* IRC § 6033(j)(1).

10 Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006). The law went into effect for tax periods beginning after 2006. *See* IRC § 6033(j)(1) (providing that the effective date of the automatic revocation is the due date of the third annual return or notice).

11 *See* IRC § 6033(j)(1). The only way an automatically revoked organization can be removed from this list is if the revocation was due to IRS error. This list of automatically revoked organizations is available online at https://apps.irs.gov/app/eos/mainSearch.do;jsessionid=dK2bhgtr3luhznjUpp62cg__?mainSearchChoice=revoked&dispatchMethod=selectSearch.

12 *See* IRC § 6033(j)(2). An automatically revoked organization may obtain retroactive reinstatement of its exempt status. *See* Rev. Proc. 2014-11, 2014-3 I.R.B. 411.

before making a donation, that their contributions will be tax deductible.[13] Second, they allow private foundations to verify that they are making a grant to a qualifying public charity.[14] IRS guidance provides that grantors and contributors may rely on an organization's listing on EO Select Check or EO BMF.[15] In addition, grantors and contributors may, in some situations, rely on EO BMF information provided by a third party.[16]

There is no current legal requirement for the IRS to update its online EO databases at any particular interval.

REASONS FOR CHANGE

The IRS recognizes that potential donors and grantors may rely exclusively on its online databases.[17] However, it does not update them in a timely manner, causing reinstated automatically revoked organizations, such as the one in the example above, to potentially lose donations or grants.[18] Currently, EO Select Check and EO BMF are only updated monthly, on the second Monday of every month.[19] An organization that misses the updating cutoff will not appear on the IRS lists until the next month. In addition, these databases are not updated at all during the month of January, meaning there is a two-month updating gap from the second Monday in December until the second Monday in February.[20] As a result, new and reinstated EOs that receive IRS approval of exemption after the early December cutoff will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising push.

The number of automatic revocation reinstatement cases during this gap period alone exceeded 2,500 in both FYs 2014 and 2015, and more than 70 percent of these cases were 501(c)(3) organizations.[21] However, the IRS disavows responsibility if an EO loses a donation or grant because its databases do

13 A charitable contribution deduction is allowed for donations to organizations described in IRC § 170(c). These are most commonly IRC § 501(c)(3) organizations.

14 Private foundations prefer making grants to qualifying IRC § 501(c)(3) public charities over other organizations as doing so relieves them of certain oversight requirements (called expenditure responsibility) that would otherwise arise, and eliminates the risk of incurring liability for an excise tax under IRC § 4945.

15 *See* Rev. Proc. 2011-33, 2011-25 I.R.B. 887.

16 *Id*.

17 *See* IRM 25.7.6.1(3) (Jan. 1, 2015); IRM 21.3.8.12.12(3) (June 18, 2012); IRM 21.3.8.12.13(3) (Nov. 16, 2012).

18 This delay may also affect newly-recognized tax exempt organizations that receive a determination letter but are not promptly listed on the online databases. However, the harm to reinstated automatically revoked organizations is arguably greater as these organizations were formerly tax exempt and had the ability to receive tax-deductible contributions.

19 IRM 21.3.8.3.8(1)(f) (Oct. 1, 2015) (noting "online Publication 78 data is generally updated the second Monday of each month"); IRM 21.3.8.12.13(2) (Nov. 16, 2012) (noting that EO BMF is updated or extracted monthly). The term "extracted" is used because the EO BMF is an extract of information regarding EO accounts from the larger BMF. *See* IRM 25.7.5.1(1) (Jan. 1, 2015). In response to a TAS information request, the IRS stated that the internal IRS EO BMF list is generally updated within two weeks of a favorable case closing. The IRS also stated that the program that produces the online EO BMF and EO Select Check extracts is run approximately the last full week of each month and posted online to irs.gov the second Monday of the following month. Any accounts that are updated and posted prior to the running of the extract program will appear online. This means that an EO account update could take between 30 to 60 days to be reflected on the online EO BMF and EO Select Check databases. TE/GE response to TAS research request (July 31, 2015). Thus, there is a disconnect between IRS internal database updating (approximately two weeks) and external (*i.e.*, online) database updating (30-60 days).

20 *See* IRM 25.7.5.1(1) (Jan. 1, 2015) (noting that the EO Standard Extract Program is a computer program that is run on a monthly basis (except for January) to allow for extraction of both entity and limited return information from EO accounts contained on the BMF).

21 TE/GE response to TAS research request (July 31, 2015).

not accurately reflect that the organization is exempt.[22] It advises reinstated organizations to either show potential contributors a current IRS determination letter or ask them to contact the IRS's TE/GE toll-free line (and face lengthy hold times, courtesy disconnects, and poor levels of service) to verify the organization's exempt status.[23] These suggestions place a burden on the reinstated organization or the 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.[24]

If the IRS were to update its online databases on a weekly basis, as it does for its list of Form 990-N (e-Postcard) filers,[25] it would alleviate the hardship on reinstated automatically revoked organizations and their donors or grantors. A legislative change requiring weekly database updating would also support fundamental taxpayer rights. Specifically, it would support donors and grantors' *right to be informed* of organizations that are tax exempt and eligible to receive tax deductible contributions. It would also support EOs' *right to quality service*, which includes a taxpayers' right to receive prompt assistance in their dealings with the IRS. Weekly database updating would also benefit the IRS by reducing the burden on the IRS's TE/GE phone line, as potential donors or grantors would no longer need to call the IRS to verify the exempt status of an organization not listed in the databases.

Although the IRS can update its EO Select Check database manually in between regular database updates and the National Taxpayer Advocate has directed TAS employees to require the IRS to do these manual updates within 24 hours, this *ad hoc* approach is not feasible or sustainable.[26] In addition, the IRS states that it cannot update the EO BMF manually.[27] Weekly database updating would limit the need for manual updates to emergency cases.

The IRS has previously moved to a more frequent updating interval, as Publication 78 data (that now appears on EO Select Check) used to be updated quarterly, but was moved to a monthly (with the exception of the gap period) updating schedule in January 2012.[28] However, due to the harm caused to many

22 IRM 21.3.8.12.13(3) (Nov. 16, 2012).

23 *See* IRS, *Exempt Organizations Select Check: Timing of Database Updates for Organizations Whose Exempt Status Is Reinstated*, *available at* http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check:-Timing-of-Database-Updates-for-Organizations-Whose-Exempt-Status-Is-Reinstated. For detailed data about hold times, courtesy disconnects, and poor levels of service, see Most Serious Problem: *Exempt Organizations (EOs): The IRS's Delay in Updating Publicly Available Lists of EOs Harms Reinstated Organizations and Misleads Taxpayers*, *supra*.

24 *See, e.g.*, Mathile Family Foundation, *FAQs – Tax Information*, *available at* http://www.mathilefamilyfoundation.org/grantmaking/faqs/tax-information/. These FAQs discuss in great detail the grant making restrictions on private foundations and that the foundation and its managers are subject to severe penalties if these rules are violated. The FAQs also advise potential grantees to **"make sure that the IRS BMF code *currently* represents your non-profit activities/operation (Form 990) and aligns with your Form 1023 filings and subsequent communications as approved by the IRS. When these separate designations do not agree, your organization is required to rectify discrepancies with IRS. Please consult with your tax advisor."** (bold and italic emphasis in original).

25 *See* IRS, *Exempt Organizations Select Check: Frequently Asked Questions*, FAQ #5, *available at* http://www.irs.gov/pub/irs-tege/faqs_eo_selectcheck.pdf.

26 In a February 2015 message to TAS employees, the National Taxpayer Advocate directed her case advocates to request manual updates within 24 hours if the IRS agrees an organization should be listed on EO Select Check as eligible to receive tax deductible contributions and to request an organization's removal from the automatic revocation list if this revocation was erroneous. TAS Wednesday Weekly, *Updates to Exempt Organizations "Select Check"* (Feb. 4, 2015).

27 TE/GE response to TAS research request (July 31, 2015). When asked why it cannot update the EO BMF manually, the IRS stated that the EO BMF is prepared by its IT personnel during a time frame available only once a month, "except in January IT is busy with other priorities and the EO BMF is not prepared." TE/GE response to TAS research request (Dec. 1, 2015).

28 IRM 25.7.6.3.5, *Cumulative List Indicator* (Jan. 1, 2015).

reinstated organizations, more frequent updating is now necessary and the IRS should implement such a change, which should not entail a significant additional cost or expenditure of resources. Because the IRS is unwilling or unable to make such a change, Congress should require it to do so.[29]

EXPLANATION OF RECOMMENDATIONS

The proposals to amend IRC § 6033 to require the IRS to update its online EO databases more frequently would address IRS delays under the current process and their adverse impact on automatically revoked organizations that have been reinstated. A requirement that the IRS update its databases on a weekly basis would eliminate the current potential month or two updating delay and should not involve significant additional costs or resources. This would be in line with the IRS online weekly updating time frame for the Form 990-N (e-Postcard), which is the notice filed by small EOs.[30]

Until the IRS can make appropriate programming changes, Congress should direct the IRS, through legislative history, to update EO Select Check manually for reinstated automatically revoked organizations. This short term fix will immediately alleviate the burden placed on these organizations. Once the IRS moves to a weekly updating schedule, the proposal recommends that Congress require the IRS to implement an emergency process that allows for manual online database updates within 24 hours of the restoration of exempt status. These changes would promote fair and efficient tax administration and protect two fundamental taxpayer rights, the *right to be informed* and the *right to quality service*.

29 In a response to a TAS information request regarding whether the IRS can update EO BMF and EO Select Check more frequently than the current monthly (except for January) intervals, the IRS stated that the program used to run these two extracts only runs every four weeks and "there is no way that the IT programmers can run the extracts more frequently." TE/GE response to TAS research request (Dec. 1, 2015).

30 EOs that normally have annual gross receipts of not more than $50,000 may file the Form 990-N rather than the more comprehensive Form 990 or Form 990-EZ. *See* Rev. Proc. 2011-15, 2011-3 I.R.B. 322.

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

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*

PROBLEM

Pass-through entities determine their income, gain, and loss at the entity level, but these items are passed out and taxed at the partner or shareholder level at the owner's income tax rate. Partnerships and S corporations are two common types of pass-through entities, which are becoming the preferred way to structure businesses. Between 1980 and 2012, the number of pass-through business tax returns increased by approximately 294 percent, from nearly two million returns to about 7.6 million returns.[2] By comparison, the number of returns filed by C corporations, which are not pass-through entities, decreased by about 25 percent.[3]

Owners of pass-through entities often hold their interest for long periods of time. When the interest in the pass-through entity is sold or liquidated, the IRS requires partners or shareholders to compute their tax basis to determine the amount of gains or losses.[4] These computations are some of the most complex in the Internal Revenue Code (IRC).

Each year, partnerships and S corporations are required to furnish Schedule K-1s to each partner or member, reporting their allocable share of income, gain, or loss, and file a copy with the IRS.[5] The Schedule K-1 does not include the partner or shareholder's annual adjusted basis in the partnership or S corporation; rather, a worksheet accompanies the instructions to assist the recipient with the calculation.[6] Taxpayers often lack the specialized knowledge required to accurately calculate basis, which results in errors and can lead to an overstatement of basis or an overpayment of tax.

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 IRS, Statistics of Income (SOI) Tax Stats – Integrated Business Data, *Business Tax Statistics, 1980-2012*, Table 1, *available at* https://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data. IRS data may double count some businesses because some private partnerships can be owned by one or more other business entities. The number of S corporation and partnership returns filed in 1980 was 1,925,043 and in 2012 the number of returns was 7,594,013.

3 *Id.*

4 IRC §§ 704, 1366.

5 IRC § 6031(b).

6 *See* IRS, *Partnership Schedule K-1 (2013)*; IRS, *Shareholder's Schedule K-1 (2013)*; IRS, *Partner's Instructions for Schedule K-1 (2013)*; IRS, *Shareholder's Instructions for Schedule K-1 (2013)*.

EXAMPLE

Pat and Sam form an equal partnership by contributing property of equal fair market value. Pat contributes $40,000 cash plus assets having an adjusted basis of $200,000 at the time of contribution. In addition, Pat transfers a mortgage on one of the assets of $80,000. Pat's beginning basis in his partnership interest is $200,000. Pat's basis is reduced by the $80,000 mortgage he transferred, but it is increased by $40,000, his share of the mortgage once it was transferred to the partnership.

Pat's adjusted basis of assets contributed:	$	200,000
Plus cash contributed:	$	40,000
Less mortgage liability transferred:	$	(80,000)
Plus partnership debt assumed:	$	40,000
Pat's initial basis:	$	200,000

Continuing with the above scenario, Sam contributes assets with a basis of $200,000 and a mortgage balance of $60,000. Sam's basis in the partnership is $210,000. Sam increases his basis by the 50 percent share of the $80,000 mortgage transferred by Pat. In addition, Pat has a new basis of $230,000 ($200,000 plus $30,000) because he increases his basis by his 50 percent share of the $60,000 mortgage contributed by Sam.

Sam's adjusted basis of assets contributed	$	200,000
Plus cash contributed:	$	0
Less mortgage contributed:	$	(60,000)
Plus partnership debt assumed (Sam):	$	30,000
Plus partnership debt assumed (Pat):	$	40,000
Sam's initial basis:	$	210,000

Pat's initial basis:	$	200,000
Plus partnership debt assumed (Sam):	$	30,000
Pat's revised initial basis:	$	230,000

If the partnership was organized as an S corporation, the calculations would be slightly different.

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.

PRESENT LAW

Determining the correct tax basis for pass-through entities is no easy task. Subchapter K,[7] which covers partnership[8] taxation, contains some of the most complicated computations in the IRC. It is closely followed in complexity by the sections pertaining to computing the tax basis for an S corporation interest in Subchapter S.[9]

There are several sections of the IRC that determine a partner's tax basis in a partnership. Each partner must calculate his or her basis in the partnership using two separate methods. First, the partner must determine his basis in the partnership interest, commonly referred to as "outside" basis.[10] Outside basis is adjusted annually to reflect the income, gains, and losses from the operation of the partnership. Second, the partner must determine his share of the partnership's basis in the partnership's assets (net of liabilities), commonly referred to as "inside" basis.[11] A partner's inside basis is maintained in a capital account and generally differs from the partner's outside basis in that the capital account does not reflect a partner's share of partnership liabilities, or optional basis adjustments under IRC § 754. These different types of basis can result in confusion and misreporting.

When a partner contributes property into a partnership in exchange for a partnership interest, the general rule is that a partner has a tax basis in the partnership interest equal to the adjusted tax basis of the assets

7 IRC §§ 701-77.

8 A partnership is the relationship existing between two or more persons who join together to carry on a trade or business. Each person contributes money, property, labor, or skill and expects to share in the profits and losses of the business. A partnership must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay income tax. Instead, it "passes through" any profits or losses to its partners in accordance with the partnership agreement. Each partner includes his or her allocable share of partnership income or loss on his or her tax return. Partnerships organized in the United States, or derive income from operations in the United States, are required to file Form 1065, *U.S. Return of Partnership Income*. IRC § 6031(a).

9 IRC §1361. S corporations are corporations that elect to pass income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income at the entity level. To qualify for S corporation status, the corporation must meet the following requirements: (1) domestic corporation; (2) eligible shareholders (*e.g.*, individuals, certain trusts, and estates are eligible shareholders and partnerships, corporations or non-resident alien are ineligible shareholders); (3) no more than 100 shareholders; (4) one class of stock. Certain corporations are ineligible to elect to be an S corporation including certain financial institutions, insurance companies, and domestic international sales corporations. IRC §§ 1361-78. Government Accountability Office (GAO), GAO-10-195, *Tax-Gap: Actions Needed to Address Noncompliance With S Corporation Tax Rules* 16 (Dec. 2009). "S corporation stakeholder representatives told us that calculating and tracking basis was one of the biggest challenges in complying with S corporation rules." Curtis J. Berger, *W(h)ither Partnership Taxation?* 47 Tax L. Rev. 105, 108 (1991) ("In order to keep tax planners from wholly abusing the partnership's privileged status, while not denying them all remaining flexibility, Congress and Treasury [fashioned] a statutory and regulatory apparatus which [is] one of the most inaccessible and burdensome features of the entire tax system."). Burgess J. W. Raby & William L. Raby, *S Corporation AAA and OAA- Alphabet Soup or Taxpayer Stew?*, 78 Tax Notes 1013 (Feb. 23, 1998) (describing Subchapter S as "remarkably complicated"). Andrea Monroe, *Integrity in Taxation: Rethinking Partnership Taxation*, 64 ALA. L. REV. 289, 316 (2012) ("Congress's desire to provide partnerships with flexible allocation provisions, coupled with the line drawing that such an approach requires, has burdened partnerships with enormous complexity. Under the substantial economic effect safe harbor, a partnership must apply multiple layers of intricate, mathematical provisions to every allocation it makes, every year."). James Alm & Jay A. Soled, *Tax Basis Determinations, Pass-Through Entities, and Taxpayer Noncompliance*. 40 Ohio N. U. L. 693, 699 (2014) ("In the area of tax law, courts, academicians, practitioners, and students generally agree that Subchapter K (the subchapter that details partnership taxation) and the Treasury regulations promulgated thereunder are extraordinarily complex.")

10 IRC §§ 722, 705.

11 IRC §§ 723, 704.

contributed to the partnership.[12] If a partner purchases a partnership interest, the partner will generally have a tax basis in the partnership interest equal to the purchase price of the interest.[13]

Once the partnership begins to conduct business, rules regarding partnership operation and partnership debt are applicable. IRC § 705 explains how a partner adjusts his basis in his partnership interest based on the entity's gains or losses and/or distributions.[14]

Similarly, computing S corporation tax basis is a daunting task. The initial basis in an S corporation is figured much like a partnership. IRC §§ 358 or 1012 govern at the inception of the S corporation.[15] Taxpayers who acquire their S corporation investment by purchase are generally given a tax basis in their S corporation shares equal to the purchase price.[16] Once operations begin, the tax basis goes through annual upward and downward adjustments based upon transactions.[17] If an S corporation incurs debt, no tax basis adjustments are made to the taxpayer's interest.[18] If a shareholder lends funds to an S corporation or personally guarantees an S corporation's debt, then the lending shareholder's will have an additional separate basis account equal to the loan or guarantee amount. A shareholder's basis attributable to loans or guarantees is only taken into account after the shareholder has reduced his tax basis to zero. The shareholder cannot reduce his basis, including his basis from the indebtedness, below zero, by loss and deduction items that flow through the S corporation.[19]

Partnerships and S corporations must file information returns (Forms 1065 and 1120-S, respectively).[20] Partnerships and S corporations generally do not directly pay taxes on the net income reported on Forms 1065 or 1120-S. Instead, they pass profits, losses, and gains to partners and shareholders, respectively, who pay any applicable taxes.[21] Partnerships and S corporations are required to furnish Schedule K-1s to their partners or shareholders to report their allocable share of income, loss, or gain for the year and to file a copy with the IRS.[22]

The Schedule K-1 for partnerships contains three parts: Part I (Information About the Partnership), Part II (Information About the Partner), and Part III (Partner's Share of Current Year Income, Deductions, Credits, and Other Items). The Schedule K-1 for S corporations mirrors the one for partnerships and has three parts. Both sets of instructions contain short sections pertaining to the calculation of

12 IRC § 722.

13 IRC § 742.

14 IRC § 705(a)(1). Basis adjustments increase for (a) the taxable income of the partnership; (b) income of the partnership exempt from tax; and (c) the excess of depletion deductions over the basis of the property subject to depletion. IRC § 705(a)(2). Basis adjustments decrease (but not below zero) for (a) partnership distributions; (b) partnership losses; (c) partnership expenditures not deductible in computing its taxable income and not properly chargeable to the taxpayer's capital account; and (d) any partnership oil and gas property, by the amount of the partner's deduction for depletion, to the extent that such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such property.

15 IRC §§ 358, 1012.

16 IRC § 1012(a).

17 IRC § 1367.

18 IRC § 1366.

19 IRC § 1367(d)(1)(B).

20 IRC §§ 6031, 6037.

21 IRC § 701.

22 IRC §§ 6031, 6037; Treas. Reg. §§ 1.6031(a)-1, 1.6037-1.

a partner's or shareholder's basis in the partnership interest or stock along with a worksheet to assist with calculations.[23]

REASONS FOR CHANGE

Taxpayer Burden

The explosion of growth of pass-through entities as a chosen business structure combined with the complexity of the laws and regulations governing basis computations create a situation where many taxpayers face some of the most complex sections of the IRC.

Partners and shareholders of pass-through entities may hold onto their interest for many years and fail to 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. Upon sale or dissolution of their interest in a pass-through entity, taxpayers face a risk for either an overstatement of basis, with a corresponding underpayment of tax, or an understatement of basis resulting in an overpayment of tax. In some larger partnerships, there are many partners trying to independently calculate their basis with their own preparers.

Revenue Protection

In March 2012, the IRS released a working paper that highlights the growing magnitude of the tax gap.[24] The results further support an earlier paper and prior research study findings — when transactions are subject to information reporting to the government, tax compliance is generally very high.[25] However, when transactions are not subject to information reporting to the government, the tax compliance rate drops tremendously.[26]

This change will increase tax compliance by eliminating the ability of partners and S corporation shareholders to overstate their basis and thereby not pay the correct amount of tax. Requiring the annual reporting of adjusted basis on the Schedule K-1 for pass-through entities will further help taxpayers to understand their basis and not pay an incorrect amount of tax. It will also serve to assist taxpayers keep accurate records of their basis and eliminate the need to reconstruct basis many years down the road when many complex adjustments have been made.

In an article written in 2014, Professors James Alm and Jay A. Soled estimated that noncompliance in the pass-through entity basis reporting results in an annual revenue loss of approximately $8 billion.[27] Pass-through entity basis reporting requirements would assist with the collection of this annual revenue loss, while reducing burden and minimizing complexity for taxpayers.

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23 *See* IRS, *Partnership Schedule K-1 (2013)*; IRS, *Shareholder's Schedule K-1 (2013)*; IRS, *Partner's Instructions for Schedule K-1 (2013)*; IRS, *Shareholder's Instructions for Schedule K-1* (2013).

24 IRS, Office of Research, *Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation* (Mar. 2012).

25 IRS, Office of Research, *Year 2001 Federal Tax Gap* (Feb. 2007); IRS, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study*, IR-2012-4 (Jan. 6, 2012). *See also* GAO, GAO-06-603, *Capital Gains Tax Gap* (2006).

26 IRS, Office of Research, *Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation* (Mar. 2012).

27 *See* James Alm & Jay A. Soled, *Tax Basis Determinations, Pass-Through Entities, and Taxpayer Noncompliance*, 40 Ohio N. U. L. 693, 721 (2014).

EXPLANATION FOR RECOMMENDATIONS

Requiring pass-through entity basis reporting annually on the Schedule K-1 is a win-win proposition for taxpayers and the government. Taxpayers will no longer have to struggle with reconstructing their basis while following the complex adjustment rules, and the government will be able to collect the proper amount of tax due and better monitor compliance.

Similar to the changes for reporting adjusted stock basis enacted in 2008, pass-through entity basis reporting will reduce the recordkeeping burden on partners and S corporation shareholders seeking to report their tax basis accurately.[28] By centralizing basis reporting with third-party preparers, the burden for accurately calculating basis lies with those who have the expertise and resources to do so. Pass-through entities employ bookkeeping services that keep the necessary information regarding basis adjustment, and it is less burdensome for the third-party preparer to issue the annual statement.

Additionally, the Government Accountability Office (GAO) found that the full extent of partnership and S corporation income misreporting is unknown. The IRS's last study of S corporations, using 2003-2004 data, estimated that these entities annually misreported about 15 percent (an average of $55 billion for 2003 and 2004) of their income. Using IRS data and the study results, the GAO derived an estimate of $91 billion per year of individuals misreporting partnership and S corporation income for 2006 through 2009.[29]

In writing regulations to require annual reporting of basis, there are some technical issues.[30] One issue involves how reporting would work in light of private party sales. Presently, there is no requirement to notify the IRS when interests in pass-through entities are bought and sold. If one of the 25 partners sells his partnership interest to a third party, the third party's initial basis will be what he paid. Because this is a private transaction, the partnership may not be privy to the sales price. If the partnership does not or cannot know the taxpayer's basis due to origination of the partnership interest either through gift or private party sale, an exception could be created to the pass-through entity basis reporting requirement. The K-1 would note that the basis calculation does not include the original purchase or gift basis of the partnership interest and only includes adjustments since that time.

A second issue involves how much additional work and change in programming to the electronic software packages the annual reporting of pass-through entity basis would require. The technology for electronic preparation and bookkeeping software already exists. Bookkeepers, Certified Public Accountants, and tax attorneys are already maintaining much of the information that individual partners are supposed to be keeping records of annually. There would be a cost and time needed for updating of the software and change in record keeping methods. The burden on preparers could possibly be mitigated by a phased in approach either by tying the reporting to assets or numbers of partners while being phased in over a period of several years.

28 IRC § 6045. Prior to the passage of IRC § 6045(g), taxpayers were required to determine basis for their marketable securities. Many, including the National Taxpayer Advocate, have argued that this resulted in an overly burdensome hardship for taxpayers. *See* National Taxpayer Advocate 2005 Annual Report to Congress 433-39.

29 GAO, GAO-14-453, *Partnerships and S Corporations: IRS Needs to Improve Information to Address Tax Noncompliance* (May 14, 2014).

30 The National Taxpayer Advocate discussed with many individuals including persons who prepare or advise on pass-through entity returns in developing the concerns and issues regarding this legislative recommendation.

The National Taxpayer Advocate believes these technical issues, while challenging, are resolvable and that an annual basis reporting requirement ultimately benefits all parties in pass-through entities, especially partners who face challenges in computing their adjusted basis to pay no more than the correct amount of tax.

LR #12 HARDSHIP WITHDRAWALS: Provide a Uniform Definition of a Hardship Withdrawal from Tax-Advantaged Retirement Arrangements

TAXPAYER RIGHTS IMPACTED[1]

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

PROBLEM

The Internal Revenue Code (IRC) contains a myriad of tax-advantaged retirement arrangements to encourage taxpayers to save for retirement.[2] While these planning vehicles help taxpayers save for retirement, they are subject to differing sets of rules regulating eligibility, contribution limits, tax treatment of contributions and distributions, withdrawals, availability of loans, and portability. TAS has discussed in prior reports the problems that such complexity may cause to both retirement plan administrators and participants.[3]

Particularly confusing are the rules governing distributions made before age 59½. 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.

IRC § 72(t) does not contain an exception to the ten percent additional tax for taxpayers whose last resort to pay for necessary living expenses is to liquidate their qualified plan. The lack of an exception negatively impacts low income taxpayers (those at or below the 250 percent of the federal poverty guidelines[4]) and those facing severe financial hardship resulting from an extended period of unemployment.[5]

Because the hardship withdrawal provisions do not apply uniformly to all qualified plans, taxpayers' *right to a fair and just tax system* is compromised[6] — that is, the type of qualified plan a taxpayer is participating in should not impact his or her ability to receive a hardship withdrawal. The current rules for

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The term "tax-advantaged" includes the ability to defer the taxation of income by making an elective deferral, the tax-deferred growth of account assets, or the tax-free withdrawals available to plan participants. Types of tax-advantaged retirement arrangements available under the IRC include traditional Individual Retirement Accounts (IRAs), Roth IRAs, rollover IRAs, SIMPLE IRAs, 401(k) plans, profit-sharing plans, employee stock ownership plans, money purchase plans, defined benefit plans, Simplified Employee Pensions, Salary Reduction Simplified Employee Pension, SIMPLE 401(k) plans for small employers, 403(b) tax-sheltered annuity plans for 501(c)(3) organizations and public schools, and 457(b) deferred compensation plans for state and local governments.

3 *See* National Taxpayer Advocate 2009 Annual Report to Congress 384-90 (Legislative Recommendation: *Provide a Uniform Definition of a Hardship Withdrawal from Qualified Retirement Plans*); National Taxpayer Advocate 2008 Annual Report to Congress 373-74 (Legislative Recommendation: *Simplify and Streamline Retirement Savings Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 423-32 (Legislative Recommendation: *Simplification of Provisions to Encourage Retirement Savings*).

4 The federal poverty guidelines are a measure of income level issued annually by the Department of Health and Human Services. *See* U.S. Dep't of Health & Human Serv., 2015 Poverty Guidelines (Sept. 3, 2015), *available at* http://aspe.hhs.gov/2015-poverty-guidelines.

5 *See* Systemic Advocacy Management System Issue 32816 (submitted Apr. 15, 2015).

6 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

hardship withdrawals are so confusing that they present a trap for the unwary, often leading to unintended consequences that unfairly harm taxpayers who, by definition, are suffering from hardship.

EXAMPLE

Taxpayer A, who is 45 years old, first opened a Roth Individual Retirement Account (IRA) account three years ago and has contributed $5,000 every year. The taxpayer's Roth IRA balance is $18,000, of which $3,000 is attributable to earnings. Taxpayer A currently works full-time for Employer B, a state agency. Taxpayer A participates in Employer B's governmental 457(b) plan and as of October 1, 2015, had $60,000 in the plan attributable to his elective contributions and contributions made by Employer B. Taxpayer A used to work for Employer C, a company that maintains a 401(k) plan for its employees and made pre-tax contributions to the 401(k) plan while Taxpayer A was employed with Employer C. Taxpayer A's account balance with Employer C's 401(k) plan is $25,000 as of October 1, 2015.

During 2015, Taxpayer A is faced with a medical emergency that will require surgery and force him to miss six months of work. Because his health insurance will cover only 70 percent of the estimated $50,000 medical expenses, Taxpayer A will have out-of-pocket costs of $15,000 for his surgery. Taxpayer A estimates he will need an additional $20,000 to cover living expenses for his family during the next six months while he is on unpaid leave.

Taxpayer A recalls that some co-workers from Employer C were allowed to make hardship withdrawals from their retirement plans for occasions such as a home purchase. Taxpayer A would like to know whether he can receive a distribution from his Roth IRA or his two employer-based plans to help pay medical and living expenses for the next six months. After spending two weeks reading through plan documents and talking with friends, colleagues, and plan administrators, Taxpayer A arrives at the following conclusions:

(1) He may withdraw $15,000 from his Roth IRA (the amount contributed) without any tax consequences. Distributions in excess of the $15,000 that will be used for medical expenses (to the extent it does not exceed the amount allowable as a deduction under IRC § 213) will not be subject to the ten percent additional tax. Any distribution he uses for living expenses while he is unable to work will be includible in taxable income to the extent the distribution exceeds his contributions to the Roth IRA and subject to the ten percent additional tax.

(2) His governmental 457(b) plan with Employer B allows in-service distributions for "unforeseeable emergencies." For this purpose, an unforeseeable emergency is a severe financial hardship resulting from an illness or accident. The ten percent additional tax does not apply to distributions from a governmental 457(b) plan.

(3) His 401(k) plan with Employer C allows in-service distributions on account of hardships. For this purpose, a hardship means an instance of "immediate and heavy financial need" and the plan provides that the regulatory safe harbor rules will be used to determine whether an employee qualifies for the distribution. Medical expenses, but not living expenses, for the period he is unable to work fall under the safe harbor definition of immediate and heavy financial need. Hardship distributions are included in taxable income and subjected to the ten percent additional tax for early withdrawal.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress establish uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged retirement plans and 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:

1. Expenses for medical care incurred by the employee, the employee's spouse, or dependents;
2. Payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence;
3. Loss of property due to casualty;
4. Basic living expenses of low income taxpayers (those at or below the 250 percent of the federal poverty guideline); or
5. Financial hardship resulting from an extended period of unemployment.

The National Taxpayer Advocate further recommends that the IRS exempt such hardship distributions from the ten percent additional tax imposed by IRC § 72(t).

PRESENT LAW

Determining the tax treatment of early distributions from certain tax-advantaged retirement arrangements involves a three-pronged analysis. First, we must ascertain whether the distribution is allowed in the first place. If allowed, there must be a determination regarding the taxability of such distribution. Finally, we must determine whether the distribution is subject to the IRC § 72(t) addition to tax.

The following sections discuss the application of this analysis with respect to distributions from various qualified plans.

401(k) Plans

In the absence of a hardship, a 401(k) plan may generally only distribute benefits attributable to elective contributions upon an employee's death, disability, attainment of age 59½, or severance from employment.[7] Applicable Treasury regulations provide that a distribution is made due to hardship only if (1) the distribution is made due to an immediate and heavy financial need of the employee, and (2) the distribution is necessary to satisfy the immediate and heavy financial need.[8]

Applicable Treasury regulations provide that whether an employee has an immediate and heavy financial need and the amount necessary to meet such need is determined by the plan administrator based on a consideration of all relevant facts and circumstances.[9] The regulations also provide a safe harbor under which a distribution may be deemed to be on account of an immediate and heavy financial need in the following six circumstances:

1. Expenses for medical care incurred by the employee, spouse, or certain dependents;
2. Costs directly related to the purchase of a principal residence for the employee;

7 IRC § 401(k)(2)(B)(i).
8 Treas. Reg. § 1.401(k)-1(d)(3)(i).
9 Treas. Reg. § 1.401(k)-1(d)(3)(iii) and (iv).

3. Payment of certain tuition, related educational fees, and room and board expenses for the employee, spouse, children, or certain dependents;
4. Payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage of that residence;
5. Payments for burial or funeral expenses for the employee's deceased parent, spouse, children, or dependents; or
6. Expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under IRC § 165.[10]

The regulations also provide that a distribution is deemed necessary to satisfy an immediate and heavy financial need if:

1. The employee has obtained all other currently available distributions and nontaxable loans under the plan and all other plans maintained by the employer; and
2. The employee is prohibited from making elective deferrals to the plan and all other plans maintained by the employer for at least six months following the hardship distribution.[11]

Hardship withdrawals are generally includible in the participant's gross income in the taxable year in which paid to the participant and are taxed as ordinary income.[12] In addition, hardship withdrawals are subject to the ten percent additional tax imposed under IRC § 72(t) if no exception applies.[13]

457(b) Plans[14]

In general, a governmental 457(b) plan (which covers state and local government employees) participant may not receive a distribution until he or she reaches age 70½ or separates from service, whichever is earlier.[15] However, a governmental 457(b) plan may permit an early distribution to a participant faced with an "unforeseeable emergency."[16]

The Treasury regulations define unforeseeable emergency as:

1. A severe financial hardship resulting from an illness or accident;
2. Loss of property due to casualty; or
3. Other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.[17]

10 Treas. Reg. § 1.401(k)-1(d)(3)(iii)(B).

11 Treas. Reg. § 1.401(k)-1(d)(3)(iv)(E).

12 IRC § 402(a).

13 Exceptions to the ten percent additional tax under § 72(t)(2)(A) include distributions: (1) made on or after the date on which the employee attains age 59½, (2) made to a beneficiary on or after the death of the employee, (3) attributable to the employee's being disabled, (4) part of a series of substantially equal periodic payments, (5) made to an employee after separation from service after attainment of age 55, (6) dividends paid with respect to stock of certain corporations, or (7) made on account of an IRS levy on the qualified plan.

14 While tax-exempt organizations may also maintain 457 plans, we will limit our discussion to governmental 457(b) plans here.

15 IRC § 457(d)(1)(A).

16 IRC § 457(d)(1)(A)(iii). If certain requirements are met, participants in 457(b) plans may be eligible to receive an in-service distribution of $5,000 or less. IRC § 457(e)(9)(A).

17 Treas. Reg. § 1.457-6(c)(2)(i).

The regulations provide several examples of events that may constitute unforeseeable emergencies, such as the imminent foreclosure of or eviction from a primary residence, the need to pay for medical expenses, or the need to pay for the funeral expenses of a spouse or dependent.[18] However, the regulations specifically note that the purchase of a home or the payment of tuition are not generally unforeseeable emergencies for purposes of this exception.[19]

The ten percent additional tax imposed by IRC § 72(t) does not apply to 457(b) plans because a 457(b) plan is not included in the definition of a "qualified retirement plan" under IRC § 4974(c).[20]

Roth IRAs

In general, a distribution from a Roth IRA is only includable in taxable income if it exceeds the IRA owner's basis in the IRA and is not a "qualified distribution."[21] For this purpose, a qualified distribution includes a distribution that is:

1. Made on or after the date on which the owner attains age 59½;
2. Made to a beneficiary or the estate of the owner on or after the date of the owner's death;
3. Attributable to the individual's being disabled; or
4. Made for a first-time home purchase.[22]

Distributions from a Roth IRA that are not qualified distributions are generally includible in taxable income to the extent the distribution exceeds the contributions to the Roth IRA and are generally subject to a ten percent tax, in addition to the ordinary income taxes on the distribution.[23] There are several statutory exceptions to the ten percent additional tax under IRC § 72(t) that include distributions that are attributable to death or disability, certain medical expenses, first-time homebuyer expenses, qualified higher education expenses, health insurance expenses of unemployed individuals, or as part of a series of substantially equal periodic payments.[24]

18 Treas. Reg. § 1.457-6(c)(2)(i).
19 *Id*.
20 IRC § 72(t)(1).
21 *See* IRC § 408A(d).
22 IRC § 408A(d)(2)(A) and (d)(5).
23 *See* IRC §§ 408A(d)(1) and 408A(d)(4)(B); IRC § 72(t).
24 IRC § 72(t)(2).

Figure 2.12.1 lists certain hardship withdrawal exceptions to IRC § 72(t).

FIGURE 2.12.1, Certain Exceptions to IRC § 72(t) Ten Percent Additional Tax for Early Distributions

	Exception	Limitations
IRC § 72(t)(2)(A)(iii)	Attributable to the employee being disabled	Medically determinable physical or mental impairment to be of long-continued and indefinite duration
IRC § 72(t)(2)(B)	Medical expenses	Distribution may not exceed amount allowable as a deduction under IRC § 213
IRC § 72(t)(2)(D)	Health insurance premiums for unemployed individuals	Distribution allowable after individual has received unemployment compensation for 12 consecutive weeks
IRC § 72(t)(2)(E)	Higher education expenses	Qualified higher education expenses (e.g., tuition, fees, books, supplies, equipment) of the taxpayer, taxpayer's spouse, or child/grandchild of taxpayer or spouse
IRC § 72(t)(2)(F)	First-time home purchases	No ownership interest in a principal residence during prior two-year period
IRC § 72(t)(2)(G)	Called to active duty	Qualified reservist distribution may be made at any time during the two-year period after the end of an active duty period

Figure 2.12.2 summarizes the early withdrawal provisions of certain tax-advantaged retirement vehicles.

FIGURE 2.12.2, Summary of Early Withdrawal Provisions of Certain Tax-Advantaged Retirement Plans and Arrangements

	401(k)	457(b) Governmental Plans	Roth IRA
Who is eligible?	Employees of all non-governmental employers	Employees and independent contractors of state & local governments	Individuals (subject to income limitations if covered by employer-provided retirement plan)
Hardship withdrawal allowed while employed or before age 59½?	Yes, if distribution is necessary to satisfy "immediate and heavy financial need"	Yes, for "unforeseeable emergency"	Yes
10% additional tax assessed?	Yes	No	Yes, to the extent the distribution exceeds contributions, except in cases of death or disability, certain medical expenses, first-time homebuyer expenses, qualified higher education expenses, health insurance expenses of unemployed individuals, or as part of a series of substantially equal periodic payments

In summary, 401(k) plan participants are able to take an early distribution of their elective deferrals while still employed with the employer maintaining the plan "upon hardship of the employee,"[25] but such distributions may be subject to the ten percent additional tax on early distributions if made before age 59½.[26] Participants in 457(b) plans are permitted to take an early distribution of their entire benefit for "unforeseeable emergencies," and those distributions, like all 457(b) distributions, are not subject to the ten percent additional tax.[27] IRAs (including Roth IRAs) are not required to limit early distributions to the account beneficiary.[28] However, such distributions are subject to the ten percent additional tax, unless an exception applies.[29]

25 IRC § 401(k)(2)(B)(i)(IV).
26 IRC § 72(t).
27 IRC § 457(d)(1)(A)(iii).
28 IRC §§ 408(d) and 408A(d).
29 IRC § 72(t)(1).

REASONS FOR CHANGE

The rules covering tax-advantaged retirement plans and arrangements are among the most intricate and complex rules of the tax code and associated regulations.[30] In particular, the hardship withdrawal provisions for certain tax-advantaged retirement plans and arrangements lack uniformity and may cause confusion among plan participants. By establishing uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged plans, Congress will reduce complexity and eliminate meaningless distinctions between the types of plans that may be offered by different types of employers.

As noted above, some retirement plans allow participants to receive an early distribution in cases of financial hardship, such as a medical emergency. There is no uniform definition of "hardship" among the various retirement plans that would enable a participant to easily determine when an early withdrawal is allowable. Even if a plan 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).

EXPLANATION OF RECOMMENDATIONS

To ensure taxpayers' *right to a fair and just tax system*, the National Taxpayer Advocate recommends that Congress establish uniform rules regarding the availability of hardship withdrawals from tax-advantaged retirement plans and arrangements. These scenarios are common examples of when a taxpayer faces an unforeseen emergency that would require him or her to tap into funds earmarked for retirement savings:

1. Expenses for medical care incurred by the employee, the employee's spouse, or dependents;
2. Payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence;
3. Loss of property due to casualty;
4. Basic living expenses of low income taxpayers (those at or below the 250 percent of the federal poverty guidelines); or
5. Financial hardship resulting from an extended period of unemployment.

Admittedly, it will be impossible to identify all possible instances of unforeseen emergencies, and there may be disagreement as to what is "unforeseen." For example, we are not including educational expenses as an unforeseen emergency that would qualify as a hardship withdrawal. Congress, in its discretion, could authorize withdrawals for other situations. If it does, it should apply the exception uniformly to all tax-advantaged retirement vehicles and exempt the exception from the ten percent additional tax uniformly.

30 Part of this complexity arises because retirement plans fall under the jurisdiction of three federal agencies — the IRS, the Department of Labor, and the Pension Benefit Guaranty Corporation.

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

TAXPAYER RIGHTS IMPACTED[1]

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

PROBLEM

In recognition of the valuable role whistleblowers can play in detecting underpayments of tax and to encourage whistleblowers to come forward, Internal Revenue Code (IRC) § 7623 permits, and in some cases requires, the IRS to compensate those who report violations of the internal revenue laws.[2] In this respect, the IRC is similar to the False Claims Act, which allows whistleblowers who report fraud on the government to share in amounts recovered from the wrongdoer.[3] In 2006, Congress amended the whistleblower provisions of the IRC to more closely parallel the provisions of the False Claims Act.[4] 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.[5] 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 those underpayments to the government.

EXAMPLE

While she is employed by X, a whistleblower learns of a tax structure involving X and several related entities and subsidiary companies.[6] When she raises concerns over the tax structure to X, X uses physical force and armed men to intimidate her, then fires her. The whistleblower reports X and the related entities to the government, assists the government with its tax investigation of X and the related entities, and is subpoenaed to provide documents to the government as part of the investigation. X and the related entities learn of the subpoena (but not the whistleblower's identity) and file multiple retaliatory actions against the whistleblower to ascertain her identity and her role in the tax investigation and to threaten and intimidate her. Defending these actions consumes the whistleblower's time, requires her to incur significant personal expense, and adversely affects her professional reputation. X and the related entities also make death threats against the whistleblower, which forces her to hire counterterrorism experts to advise her family on safety and to protect her on trips abroad.

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 IRC § 7623.

3 False Claims Act, 31 U.S.C. §§ 3729-3733, discussed below.

4 For a discussion of the legislative history of IRC § 7623 and the False Claims Act, see Most Serious Problem: *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*, *supra*.

5 31 U.S.C. § 3730(h), discussed below, contains the anti-retaliation provisions of the False Claims Act.

6 The facts of this example are based on the court's description of events in *Whistleblower 11332-13W v. Comm'r*, T.C. Memo. 2014-92.

There are no IRC provisions affording the whistleblower a remedy for the retaliation she experienced as a consequence of investigating whether X and the related companies underpaid taxes and reporting the underpayments to the government. Other potential whistleblowers faced with this lack of protection from retaliation may hesitate to ascertain whether their employers underpay tax and may decide not to report tax underpayments to the government. Those who do come forward may hesitate to contest the IRS's award determination out of fear that further proceedings will increase the chances their employers will learn their identity and retaliate against them, for which they will have no remedy under the IRC.

RECOMMENDATIONS

To address the lack of a remedy available to tax whistleblowers subject to retaliation, 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.

PRESENT LAW

The False Claims Act provides for a civil suit for statutory penalties and damages against a person who "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval," and allows a whistleblower to share in the collected proceeds from such a suit.[7] In 1986, recognizing that "few individuals will expose fraud if they fear their disclosures will lead to harassment, demotion, loss of employment, or any other form of retaliation," Congress added an anti-retaliation provision to the False Claims Act.[8] Amendments in 2009 extended anti-retaliation protection to "[a]ny employee, contractor, or agent," and clarified that the provision:

> Protects not only steps taken in furtherance of a potential or actual *qui tam* action, but also steps taken to remedy the misconduct through methods such as internal reporting to a supervisor or company compliance department and refusals to participate in the misconduct that leads to the false claims, whether or not such steps are clearly in furtherance of a potential or actual *qui tam* action.[9]

Further amendments in 2010 supplied a three-year statute of limitations for seeking relief from retaliatory conduct.[10]

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7 *See* 31 U.S.C. § 3729(a)(1)(A)-(G) for enumerated acts that give rise to liability. Under the False Claims Act, if the government declines to bring a civil suit for statutory penalties and damages on the basis of a whistleblower's information, the whistleblower may bring suit on behalf of the government, in what is referred to as a *qui tam* suit, and share in the collected proceeds. 31 U.S.C. § 3730. Whistleblowers in other areas of the law who are protected from retaliation are not necessarily rewarded for identifying or reporting illicit activity. *See* Joel D. Hesch, *Whistleblower Rights and Protections: Critiquing Federal Whistleblower Laws and Recommending Filling in Missing Pieces to Form a Beautiful Patchwork Quilt*, 6 Liberty U. L. Rev. 51 (2011), grouping federal whistleblower statutes into six categories: (1) reporting fraud against the government; (2) federal employees reporting violations of laws, waste, or mismanagement; (3) reporting discrimination; (4) reporting violations of environmental laws; (5) reporting conduct adverse to health; and (6) reporting violations of securities law.

8 False Claims Amendments Act of 1986, S. Rep. No. 99-345, at 34, *reprinted in* 1986 U.S.C.C.A.N. 5266, 5299.

9 Fraud Enforcement and Recovery Act of 2009 (FERA), Pub. L. No. 111-21, § 4, 123 Stat. 1617, 1621 (2009), extending protection not only to acts taken "in furtherance of an action under this section" but also to acts taken "in furtherance of other efforts to stop 1 or more violations of this subchapter [the False Claims Act]"; 155 Cong. Rec. E1295, 1300 (daily ed. June 3, 2009) (statement of Rep. Berman).

10 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1079A(c)(2), 124 Stat. 1376, 2077, adding paragraph (3), superseding *Graham Cnty. Soil & Water Conservation Dist. v. U.S. ex rel. Wilson*, 545 U.S. 409 (2005) (holding that the statute of limitations for the most closely analogous state cause of action applies).

As amended, the anti-retaliation provision of the False Claims Act states:

1. In general. – Any employee, contractor, or agent shall be entitled to all relief necessary to make that employee, contractor, or agent whole, if that employee, contractor, or agent is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment because of lawful acts done by the employee, contractor, agent or associated others in furtherance of an action under this section or other efforts to stop 1 or more violations of this subchapter.
2. Relief. – Relief under paragraph (1) shall include reinstatement with the same seniority status that employee, contractor, or agent would have had but for the discrimination, 2 times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys' fees. An action under this subsection may be brought in the appropriate district court of the United States for the relief provided in this subsection.
3. Limitation on bringing civil action. – A civil action under this subsection may not be brought more than 3 years after the date when the retaliation occurred.[11]

In addition to federal legislation, many states have anti-retaliation statutes to protect whistleblowers.[12] Notably, New York's False Claims Act proscribes retaliatory conduct by *prospective* employers, important protection for whistleblowers whose chief concern is obtaining and retaining future employment (rather than returning to the job from which they were fired).[13]

The False Claims Act does not apply to tax fraud.[14] The tax whistleblower provision is in IRC § 7623, which Congress amended in 2006 by *requiring* the IRS to pay awards in some cases, creating the IRS Whistleblower Office (WO), and providing for United States Tax Court review of the WO's award determinations.[15] The purpose of the amendments was to encourage tax whistleblowers.[16] In 2012, the Tax Court, recognizing that whistleblowers sometimes face serious threats of retaliation, formalized its procedures for allowing whistleblowers to proceed anonymously.[17] However, neither IRC § 7623 nor any other Code provision contains an anti-retaliation provision.

11 31 U.S.C. § 3730(h).

12 Ethan D. Wohl, *Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure*, 12 Fordham J. Corp. & Fin. L. 551, 557 (2007), noting that "forty-seven states have enacted statutes protecting public-sector whistleblowers, and seventeen states also provide some statutory protection for private sector employees who report illegal conduct."

13 N.Y. State Fin. Law § 191 (2010).

14 31 U.S.C. § 3729(d) provides: "[t]his section does not apply to claims, records, or statements made under the Internal Revenue Code of 1986."

15 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 406(a)(1)(D), (b), 120 Stat. 2922, 2958-2959 (adding subsection (b) to IRC § 7623 and in an "off-Code" provision creating the Whistleblower Office); IRC § 7623(b)(4) (providing for Tax Court review of the IRS's award determination).

16 *See Grassley Says IRS, Treasury Need to Put Out "Welcome Mat" for Whistleblowers*, 2006 TNT 112-96 (June 12, 2006).

17 See *Whistleblower 14106-10-W v. Comm'r*, 137 T.C. 183, 203 (2011), noting the anti-retaliation provision of the False Claims Act, the existence of state statutes protecting workers who report illegal conduct from retaliation, and the "stark" contrast with the lack of an anti-retaliation provision in IRC § 7623; U.S. Tax Court Rules of Practice and Procedure, Rule 345, *Privacy Protections for Filings in Whistleblower Actions* (effective July 6, 2012); *see also* U.S. Tax Court, *Press Release* (Dec. 28, 2011), *available at* www.ustaxcourt.gov/press/122811.pdf (discussing the adoption of a new Rule 345).

REASONS FOR CHANGE

Employees may be uniquely qualified to detect their employers' underpayments of tax, and in many instances, the only way the IRS would know about a given transaction or behavior is because someone blew the whistle. Congress, by amending IRC § 7623 in 2006, intended to encourage tax whistleblowers to come forward. However, if the employer learns of an employee's investigation or that the employee reported its tax underpayments to the government, then retaliation against the employee may ensue. The Tax Court recognized this reality and adjusted its rules accordingly.[18] Despite the IRS's and Tax Court's measures to protect whistleblowers' identities, it may not be difficult for an employer to determine who, out of a small group of informed employees, came forward to the IRS. As one district court judge observed:

> The case law, academic studies, and newspaper accounts well document the kind of treatment that is usually visited upon public and private employees who speak out as a matter of conscience on issues of public concern. For example, a six-year study on whistleblowers by Myron Peretz Glazer and Penina Migdal Glazer details the full spectrum of management retaliation against ethical resistors who speak out against company or government policy and the long-term adverse consequences such employees can face. See Myron Peretz Glazer and Penina Migdal Glazer, *The Whistleblowers: Exposing Corruption in Government and Industry* 231 (1990) (study of sixty-four whistleblowers showed significant percentage "remain out of work or underemployed, bitter about their punishment, and uncertain of ever being able to restore their lives fully").[19]

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. The lack of such a provision may also have a chilling effect on whistleblowers' willingness to challenge the IRS's determination of the amount of their award. A whistleblower may prefer to truncate or avoid altogether any administrative or judicial proceeding, fearing an increased likelihood his or her identity will become known and will result in retaliation for which there will be no remedy under the IRC.

EXPLANATION OF RECOMMENDATIONS

The proposal would require a new IRC provision or the amendment of an existing provision to provide a remedy for a tax whistleblower who is subjected to retaliation for investigating or reporting underpayments of tax. The provision could be modeled on section 3730(h) of the False Claims Act, and could further be made applicable to prospective employers. 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 rights to pursue administrative and judicial review of the IRS's award determination.

18 *See Whistleblower 14106-10-W v. Comm'r*, 137 T.C. 183, 201 (2011), quoting *Mgmt. Info. Technologies, Inc. v. Alyeska Pipeline Serv., Co.*, 151 F.R.D. 478, 481 (D.D.C. 1993).

19 *Mgmt. Info. Technologies, Inc. v. Alyeska Pipeline Serv., Co.*, 151 F.R.D. 478, 481 (D.D.C. 1993).

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)

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Confidentiality*

PROBLEM

In 1976, when Congress amended Internal Revenue Code (IRC) § 6103 to generally prohibit the disclosure of tax return or return information, it also enacted what is now IRC § 7431, authorizing civil suits for damages for knowing or negligent unauthorized disclosures, and enhanced IRC § 7213, a criminal enforcement provision that penalizes willful unauthorized disclosures.[2] The maximum amount of statutory damages ($1,000) or fines ($5,000) under these provisions has remained the same for almost four decades. In 1997, Congress added IRC § 7213A, criminalizing the willful unauthorized inspection of returns or return information; eighteen years later, the $1,000 maximum fine under this provision is the same.[3]

The Internal Revenue Service (IRS) discloses taxpayers' returns and return information to whistleblowers pursuant to exceptions to IRC § 6103.[4] However, a whistleblower is not subject to the civil or criminal penalty provisions of IRC §§ 7431, 7213, or 7213A for unauthorized inspection or re-disclosure of that information. Tax whistleblowers are also not subject to the safeguarding requirements of IRC § 6103(p).

EXAMPLE

Whistleblower X, while assisting the IRS in detecting A's underpayments of tax, acquires return information about A, such as:

- The reporting positions on A's return that resulted in the underpayments;
- Other items on A's tax return, including A's earnings, the identity of A's dependents, the amount of alimony A claimed as a deduction, A's religious and political affiliations, and the recipients of A's charitable donations;
- A's tax compliance history, including the fact that A was audited several times over the past ten years and assessed additional amounts; and
- Communications between A and the IRS that would be embarrassing to A if made public.

1 *See* Taxpayer Bill of Rights *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), in § 1202(a) amending IRC § 6103; in § 1202(e) enacting IRC § 7217, later redesignated as IRC § 7431, authorizing civil suits for damages; and in § 1202(d) amending IRC § 7213(a) to make willful unauthorized disclosure of return information a felony rather than a misdemeanor, increase the maximum imprisonment from one year to five years, and increase the maximum fine from $1,000 to $5,000, among other things.

3 Taxpayer Browsing Protection Act, Pub. L. No. 105-35, § 2(a), 111 Stat. 1104 (1997), authorizing imposition of a maximum fine of $1,000 and imprisonment of up to one year.

4 *See, e.g.*, IRC § 6103(k)(6) and (h)(4), discussed below.

X does not take any measures to safeguard A's return information, such as maintaining a secure place to store it, restricting access to it, or returning or destroying the information when there is no longer a need for it.

Pursuant to IRC § 7623(b), X receives a portion of the proceeds the IRS collects after auditing A and assessing additional amounts. Thereafter, X makes public the return information he learned about A while assisting the IRS. IRC § 7431 provides for civil suits for the unauthorized inspection or disclosure of return information by IRS employees, among others, but with one exception not present here, the statute does not specifically apply to whistleblowers.[5] Even if A could bring suit against X pursuant to IRC § 7431, A's recovery may not sufficiently compensate him or aid in the enforcement of confidentiality rules.

RECOMMENDATIONS

To address the lack of an effective remedy for injury sustained by taxpayers whose return information is inspected or disclosed by a tax whistleblower without authorization, and to aid in the enforcement of the confidentiality rules, the National Taxpayer Advocate recommends that Congress:

1. 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;
2. Amend IRC § 7431, which authorizes a civil suit for the negligent or knowing unauthorized inspection or disclosure of return or return information, to increase statutory damages to a more substantial amount, such as $5,000, for violations by tax whistleblowers seeking or obtaining an award pursuant to IRC § 7623(b);
3. Amend IRC §§ 7213 and 7213A, which sanction willful unauthorized disclosure or inspection of return or return information, to increase the maximum amount of fines to more substantial amounts, such as $20,000 and $1,500, respectively; and
4. Amend IRC § 6103(p) to make tax whistleblowers subject to its safeguarding requirements.

PRESENT LAW

Prior to 1976, income tax returns were "public records," open to inspection under regulations approved by the President, or under Presidential order.[6] The Senate Finance Committee, in its report on H.R. 10612, the Tax Reform Act of 1976, proposed significant revisions to the treatment of tax returns and other information, noting:

> Although present law describes income tax returns as "public records", open to inspection under regulations approved by the President, or under Presidential order, the committee felt that returns and return information should generally be treated as confidential and not subject

5 The exception is when the IRS enters into a contract, sometimes referred to as a "tax administration contract" with a whistleblower pursuant to IRC § 6103(n). *See* Treas. Reg. § 301.6103(n)-2(c). The IRS has never entered into a tax administration contract with a tax whistleblower.

6 S. Rep. No. 94-938, 94th Cong., 2d Sess. (1976) at 318.

> to disclosure except in those limited situations delineated in the newly amended section 6103 where the committee decided that disclosure was warranted.[7]

The Tax Reform Act of 1976 changed several aspects of IRC § 6103 (*e.g.*, by broadly defining "return" and "return information"), and added or amended other code sections to enhance enforcement of the nondisclosure rules.[8] However, the Act did not extend the restrictions on disclosure to everyone who receives returns or return information; IRC § 6103 contains no provision concerning disclosures by whistleblowers specifically. Moreover, existing exceptions to the general rule of nondisclosure that allow the IRS to disclose return information to whistleblowers were left undisturbed. For example, IRC § 6103(k)(6) allows what are sometimes referred to as "investigative disclosures," necessary to obtain information related to the IRS's official duties or to accomplish properly any activity connected with such official duties. IRC § 6103(h)(4) allows the IRS to disclose returns and return information during an administrative proceeding, including a whistleblower administrative proceeding.[9] A whistleblower and the IRS may enter into a contract under IRC § 6103(n), sometimes referred to as a "tax administration" contract, for the whistleblower's services relating to the detection of violations of the internal revenue laws or related statutes, and the IRS may disclose return information in connection with the contract.

The 1976 Act added IRC § 7217, later designated IRC § 7431, "to redress any injury sustained and to aid in the enforcement of the confidentiality rules."[10] The statute provides that a taxpayer whose return or return information was knowingly or negligently inspected or disclosed in violation of IRC § 6103 may recover actual damages or statutory damages of $1,000, as well as court costs and attorney's fees, for such unauthorized inspection or disclosure. Congress provided for recovery of statutory damages in recognition of "the difficulty in establishing in monetary terms the damages sustained by a taxpayer as the result of the invasion of his privacy caused by an unlawful disclosure of his returns or return information."[11]

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7 S. Rep. No. 94-938, 94th Cong., 2d Sess. (1976) at 318.

8 As amended, IRC § 6103(b)(1) defines "return" as "any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed." IRC § 6103(b)(2)(A) defines "return information" to include "a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense." *See* Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 343 (Dec. 29, 1976), noting that "Congress decided that the prior provisions of law designed to enforce the rules against the improper use or disclosure of returns and return information were inadequate."

9 Treas. Reg. § 301.6103(h)(4)-1. The IRS's notification to the whistleblower of a preliminary, or proposed, award through a preliminary award recommendation letter, which the whistleblower may dispute, is the beginning of an IRC § 6103(h)(4) administrative proceeding. Treas. Reg. § 301.7623–3(b)(1); Treas. Reg. § 301.7623–3(c)(1). Issuance of a preliminary denial letter or preliminary rejection letter in IRC § 7623(b) cases also marks the beginning of a whistleblower administrative proceeding. *See* Treas. Reg. § 301.7623-3(c)(7) and (8). The National Taxpayer Advocate recommends revising 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 Form 211, *Application for Award for Original Information*. *See* Most Serious Problem: *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*, *supra*.

10 S. Rep. No 94-938, 94th Cong., 2d Sess. (1976) at 347; Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(e), 90 Stat. 1520, 1687 (1976). IRC § 7217 was redesignated as IRC § 7431 by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, § 357, 96 Stat 324, 645-6.

11 Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 345 (Dec. 29, 1976).

The statute also provides for recovery of punitive damages if the inspection or disclosure was willful or the result of gross negligence.[12]

As noted, IRC § 7431 applies to inspections and disclosures "in violation of any provision of IRC § 6103," and thus does not generally apply to disclosures by whistleblowers, who are not generally subject to the nondisclosure rules of IRC § 6103.[13] An exception to this general rule is where a tax whistleblower discloses a taxpayer's return or return information obtained in connection with a contract authorized by IRC § 6103(n). In that situation, regulations provide that the civil remedies afforded by IRC § 7431 would be available to a taxpayer whose return or return information was re-disclosed by the whistleblower.[14] However, the IRS has never entered into an IRC § 6103(n) contract with a tax whistleblower.

The 1976 Act also adjusted IRC § 7213(a) to make the willful disclosure of returns or return information a felony rather than a misdemeanor, increase the maximum imprisonment from one year to five years, and increase the maximum fine from $1,000 to $5,000.[15] The sanction applies to, among others, federal and state employees, and would apply to a tax whistleblower with whom the IRS entered into a contract pursuant to IRC § 6103(n).[16] Where disclosure of return information to a whistleblower violates the law, *e.g.*, disclosure by a federal employee in violation of IRC § 6103, the whistleblower would be subject to the penalty for publishing the information.[17] However, the sanction does not apply to whistleblowers who acquire return information legitimately pursuant to IRC § 6103(k)(6) or (h)(4) and then re-disclose the information.

In 1997, Congress further protected taxpayers' returns and return information by enacting IRC § 7213A, a new criminal penalty providing for a fine of up to $1,000 and imprisonment of up to one year for willful unauthorized inspection of any tax return or return information.[18] Like IRC § 7213, this penalty would apply to tax whistleblowers with whom the IRS entered into a contract pursuant to IRC § 6103(n), but does not apply to tax whistleblowers who acquire return information pursuant to IRC § 6103(k)(6) or (h)(4).[19]

12 In 1982, Congress redesignated this statute as IRC § 7431 and amended it to provide that if a U.S. officer or employee knowingly or negligently discloses return information in violation of the disclosure restrictions, the wronged party will be permitted to bring a civil action for damages against the U.S. (rather than against the officer or employee). If a person other than a federal employee violates IRC § 7431, a suit may be brought against that person in District Court. The provisions setting the amount of liquidated damages was left unchanged. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, § 357, 96 Stat. 324, 645-6.

13 IRC § 7431(a)(2) provides: "If any person who is not an officer or employee of the United States knowingly, or by reason of negligence, inspects or discloses any return or return information with respect to a taxpayer *in violation of any provision of section 6103* or in violation of section 6104(c), such taxpayer may bring a civil action for damages against such person in a district court of the United States" (emphasis added).

14 Treas. Reg. § 301.6103(n)-2(c).

15 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(d), 90 Stat. 1520, 1686-7 (1976).

16 IRC § 7213(a)(1), (2); *see also* Treas. Reg. § 301.6103(n)-2(c).

17 IRC § 7213(a)(3) provides: "Other persons: It shall be unlawful for any person to whom any return or return information (as defined in section 6103(b)) is disclosed in a manner unauthorized by this title thereafter willfully to print or publish in any manner not provided by law any such return or return information."

18 Taxpayer Browsing Protection Act, Pub. L. No. 105-35, § 2(a), 111 Stat. 1104 (1997).

19 IRC § 7213A(a)(1)(B); *see also* Treas. Reg. § 301.6103(n)-2(c).

The 1976 Act also amended IRC § 6103 to impose safeguarding requirements on Federal and State agencies, among others, that receive return information pursuant to exceptions to IRC § 6103.[20] The safeguarding requirements were intended as "a comprehensive system of administrative, technical, and physical safeguards designed to protect the confidentiality of the returns and return information and to make certain that they are not used for purposes other than the purposes for which they were disclosed."[21] Affected recipients of return information are required, as a condition of receiving the information, to explain how they will safeguard it.[22] Thereafter, they are required to maintain a secure area for storing the return information, restrict access to it, return or destroy it when they are finished with it, and "provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information."[23] The safeguarding provisions of IRC § 6103(p)(4) do not apply to whistleblowers specifically. A whistleblower who receives return information in connection with an IRC § 6103(n) contract, however, would be subject to separate safeguard provisions, including the requirement, as a condition to disclosure, that the whistleblower "permit an inspection of the whistleblower's or the legal representative's premises by the IRS."[24]

In 2006, Congress significantly expanded the reach of IRC § 7623, which authorizes the IRS to pay awards to tax whistleblowers who assist it in detecting underpayments of tax or "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same."[25] Under IRC § 7623(a), the IRS has discretionary authority to make awards to whistleblowers. The 2006 amendments added subsection (b) to the statute, making whistleblower awards mandatory in certain cases, generally specifying an award amount from 15 to 30 percent of the tax recovered (with no cap on the amount of the award), creating the IRS Whistleblower Office (WO), and providing for United States Tax Court review of whistleblower award determinations.[26] The new provision generally applies if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000.[27]

REASONS FOR CHANGE

Since 2006, when Congress enhanced the provisions of IRC § 7623 by adding subsection (b), whistleblowers have responded by seeking awards pursuant to subsection (b), as well as continuing to seek discretionary awards under subsection (a).[28] Although the IRS shares return information with whistleblowers pursuant to exceptions to the general rule of nondisclosure under IRC § 6103, it has never entered into a tax administration contract with a whistleblower pursuant to IRC § 6103(n). Thus, in the event a whistleblower re-discloses return information legitimately acquired pursuant to an IRC § 6103 exception,

20 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(a), 90 Stat. 1520, 1683-4 (1976), adding subsection (p)(4) to IRC § 6103.

21 Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 341 (Dec. 29, 1976).

22 IRC § 6103(p)(4)(E).

23 IRC § 6103(p)(4)(B-D, F).

24 Treas. Reg. § 301.6103(n)-2(d)(3).

25 IRC § 7623(a).

26 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 406(b), 120 Stat. 2922, 2958-9, adding subsection (b) to IRC § 7623, including subsection (b)(4) which provides for Tax Court review of the IRS's award determination, and creating the Whistleblower Office in an "off-Code" provision. IRC § 7623(b)(2) and (3) authorize awards of less than 15 percent in certain cases.

27 IRC § 7623(b)(5). If the award is made with respect to an individual taxpayer, the individual's gross income must exceed $200,000 for any taxable year subject to the IRS's action.

28 *See* Most Serious Problem: *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*, *supra*.

no provision in the IRC provides for a civil suit against the whistleblower, and the whistleblower is not subject to any criminal sanction under the Code. That whistleblowers are not subject to the safeguarding provisions of IRC § 6103(p)(4) leaves taxpayers at an even greater risk of dissemination of their confidential return information.

Even if they applied to whistleblowers who do not have an IRC § 6103(n) contract, the maximum amount of statutory damages ($1,000) and fines ($5,000) imposed by IRC §§ 7431, 7213, and 7213A are insufficient to "redress any injury" or "aid in the enforcement of the confidentiality rules." The $1,000 maximum amount of statutory damages under IRC § 7431 and the $5,000 maximum fine imposed by IRC § 7213 were both established in 1976, four decades or so ago. The same amounts in 2015 dollars, adjusted for inflation, are about $4,000 and $21,000, respectively.[29] The $1,000 maximum fine under IRC § 7213A has been in place since 1997, and is about $1,500 in 2015 dollars.[30]

EXPLANATION OF RECOMMENDATIONS

The proposals would make the provisions of IRC §§ 7431, 7213, and 7213A applicable to whistleblowers whether or not the whistleblower has entered into an IRC § 6103(n) contract, and would make the safeguarding provisions of IRC § 6103(p)(4) applicable to such whistleblowers. These changes are intended to protect taxpayers' fundamental right to confidentiality and thereby enhance voluntary reporting and compliance with the tax laws.

The statutory minimum award to a whistleblower under IRC § 7623(b), where the amount in dispute must be at least $2 million, is generally 15 percent of the collected proceeds. Whistleblowers who seek these awards should be subject to greater liability if they re-disclose returns or return information they obtained while earning, or attempting to earn, their award, or in the award determination process. Thus, the proposal would increase the amount of statutory damages provided by IRC § 7431 to a more substantial amount, such as $5,000, for violations by whistleblowers who request awards under IRC § 7623(b).

The penalties imposed by IRC §§ 7213 and 7213A apply to willful behavior, and the existing fines, which have been unchanged for decades, are insufficient to punish or deter it. Thus, the proposal would increase the amount of these fines to more substantial amounts, such as $20,000 and $1,500, respectively.

29 When adjusted for inflation, $1,000 in 1976 is worth $4,166 in 2015, and $5,000 in 1976 is worth $20,829 in 2015. TAS Research (Dec. 3, 2015).

30 When adjusted for inflation, $1,000 in 1997 is worth $1,477 in 2015. TAS Research (Dec. 3, 2015).

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

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

PROBLEM

Pursuant to two separate statutory regimes, U.S. taxpayers may be required to report their ownership of foreign bank accounts to the government.[2] If the foreign account balance exceeds $10,000 at any time during the year, the taxpayer must file an FBAR, pursuant to provisions of Title 31 of the U.S. Code.[3] If the balance exceeds $75,000 at any time during the year or exceeds $50,000 on the last day of the year, the same taxpayer, if an individual living in the U.S., must again report the foreign account, this time on IRS Form 8938, *Statement of Specified Foreign Financial Assets*.[4] Filing Form 8938 is required pursuant to provisions of FATCA, codified in the Internal Revenue Code (IRC), which is Title 26 of the U.S. Code.[5] Both the FBAR and FATCA statutory regimes impose penalties on foreign account holders for failing to report as required, and the IRS may assess and collect penalties under both statutes for the same failure to report.[6]

The IRC permits, and in some cases requires, the IRS to pay an award to whistleblowers who provide information that assists the IRS "in detecting underpayments of tax, or detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same."[7] The amount of the award, paid "from the proceeds of amounts collected," or "collected proceeds," takes into account

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Bank Records and Foreign Transactions Act, better known as the Bank Secrecy Act (BSA), Pub. L. No. 91-508, 84 Stat. 1114 (1970), portions of which are codified at 31 U.S.C. §§ 5311-5332; FATCA, enacted as part of Title V of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

3 31 U.S.C. § 5314.

4 *See* Treas. Reg. § 1.6038D-2(a) (containing other thresholds for married taxpayers filing a joint return and those living abroad).

5 FATCA, Pub. L. No. 111-147, § 511(a), 124 Stat. 71, 109 (2010), adding IRC § 6038D to the IRC. As discussed below, FATCA also requires foreign financial institutions (FFIs), in order to avoid withholding on certain U.S. source income, to report to the U.S. government accounts with balances in excess of $50,000 belonging to U.S. persons. *See* IRC § 1471.

6 31 U.S.C. § 5322; IRC § 6038D(d). The authority to assess and collect FBAR penalties has been delegated to the IRS. 31 C.F.R. § 1010.810(g). The National Taxpayer Advocate has questioned the appropriateness of twice penalizing the same failure to report, noting "penalizing someone more than once for essentially the same mistake—failing to report a foreign account—may be considered stacking, which is generally not viewed as an effective way to promote compliance, in part because it is perceived as confusing, disproportionate, and unfair." National Taxpayer Advocate 2014 Annual Report to Congress 335 (Legislative Recommendation: *FBAR Forms: Reduce the Burden of Foreign Account Reporting*).

7 IRC § 7623.

penalties the IRS collected for violations of FATCA.[8] However, the award does not take into account penalties the IRS collected for FBAR violations.[9] This imbalance may discourage whistleblowers from reporting foreign bank accounts to the IRS.

EXAMPLE

A U.S. citizen with dual nationality, X, owns a foreign bank account that had a $10 million balance throughout 2015. X reports on Schedule B of his U.S. tax return that he does not own a foreign bank account and he does not file an FBAR with respect to the account. Pursuant to an agreement with the IRS, X's bank reports to the IRS the names of its account owners who are U.S. persons. Because X has concealed from his bank the fact that he is a U.S. citizen, however, the bank does not report X's account to the IRS. A tax whistleblower, Y, informs the IRS of X's foreign bank account. The IRS verifies the existence of the account and the account balances and assesses against X a $10,000 penalty for failing to report the account as required by FATCA. The IRS also assesses against X a penalty of $5 million for failing to file an FBAR. The IRS collects both penalty amounts. Because the IRS would not have known of the bank account had Y not come forward, and because Y meets the other requirements for obtaining an award under IRC § 7623, the IRS proposes to award Y a portion of the $10,000 FATCA penalty it collected from X. The IRS will not award Y any of the $5 million FBAR penalty it collected from X.

RECOMMENDATIONS

To address the inconsistency with which amounts collected by the IRS on the basis of whistleblower information are included in a whistleblower award, the National Taxpayer Advocate recommends that Congress 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.[10]

PRESENT LAW

FBAR Reporting Requirements

31 U.S.C. § 5314 authorizes the Secretary of the Treasury to require U.S. citizens, residents, and entities to report their foreign bank accounts.[11] Under this authority, the Secretary of the Treasury developed Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*, requiring information about all foreign accounts exceeding $10,000 at any time during the calendar year.[12] Under

8 IRC § 7623.

9 *See* PMTA 2012-10 (Apr. 23, 2012).

10 *See* Legislative Recommendation: *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 Requirements of IRC § 6103(p)*, *supra*.

11 31 U.S.C. § 5314(a) provides: "the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency. The records and reports shall contain the following information in the way and to the extent the Secretary prescribes…"

12 31 C.F.R. § 1010.350. FBARs are now filed electronically on FinCEN Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*, *available at* http://www.fincen.gov/forms/bsa_forms/.

31 U.S.C. § 5321(a)(5)(C), a person who willfully violates the requirement to file an FBAR is subject to 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.[13] The Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury tasked with enforcing the FBAR provisions, delegated its authority to enforce FBAR provisions to the IRS in 2003.[14]

FATCA Reporting Requirements

U.S. citizens, resident aliens, and certain non-resident aliens with certain assets, such as foreign bank accounts, in excess of a specified threshold must file IRS Form 8938.[15] A person who fails to make the required disclosure on Form 8938 is subject to a penalty of $10,000, which rises as high as $60,000 if the nondisclosure continues after notification from the IRS.[16] Form 8938, as the Government Accountability Office (GAO) has observed, duplicates much of the information required on the FBAR.[17] The National Taxpayer Advocate has recommended coordinating the two regimes by raising the FBAR filing threshold to $50,000 and aligning the two reporting requirements so that one form could be used to report affected accounts.[18]

In addition to requiring the foreign account holder to file Form 8938, FATCA generally requires foreign financial institutions (FFIs) to report to the U.S government information about individual account holders who are U.S. persons and whose accounts exceed $50,000.[19]

Awards to Whistleblowers

Both Title 31 and the IRC authorize the payment of awards to whistleblowers. Under 31 U.S.C. § 5323, which the IRS does not administer, the payment of such an award, which cannot exceed $150,000, is discretionary.[20] Funds for such awards must be appropriated (*i.e.*, paying the awards must be separately

13 Under 31 U.S.C. § 5321(a)(5)(A), the Secretary of the Treasury has discretion to impose a penalty of up to $10,000 for non-willful violations. Criminal sanctions for failing to file FBARs also apply, and can result in penalties of up to $500,000. *See* 31 U.S.C. § 5322(a), (b) (providing for a penalty of up to $250,000 and imprisonment of up to five years for willful violations and a penalty of up to $500,000 and imprisonment of up to ten years for willful violations "while violating another law of the United States or as part of a pattern of any illegal activity involving more than $100,000 in a 12-month period"). As discussed in PMTA 2012-10 (Apr. 23, 2012), pursuant to 42 U.S.C. § 10601(b)(1), such amounts are currently paid into the Crime Victims Fund. This proposal does not include making these recovered criminal fines subject to awards under IRC § 7623.

14 31 U.S.C. § 310; 31 C.F.R. § 1010.810(g).

15 IRC § 6038D; Treas. Reg. § 1.6038D-2(a)(1)-(4). An unmarried taxpayer living in the U.S. must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. This threshold is doubled in the case of specified individuals who are married filing jointly. A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly.

16 IRC § 6038D(d)(1) and (d)(2). The two penalties contemplated by IRC § 6038D(d) can potentially aggregate to $60,000.

17 GAO, GAO-12-403, *Reporting Foreign Accounts to IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 15 (Feb. 2012).

18 *See* 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, supra*; National Taxpayer Advocate 2014 Annual Report to Congress 343-45.

19 *See* IRC § 1471(c),(d)(1). Non-compliant FFIs will be subject to a thirty percent withholding penalty on certain U.S. source payments made to the institution. *See* IRC § 1471(a).

20 31 U.S.C. § 5323(a).

authorized by Congress).[21] No funds have been so appropriated, and no awards have been paid under this provision.[22] Under IRC § 7623(a), the IRS has discretionary authority to make awards to whistleblowers out of "proceeds of amounts collected." If the requirements of IRC § 7623(b) are met, the IRS *is required* to pay an award out of "collected proceeds." For awards under IRC § 7623(b), appropriated funds are apportioned by the Office of Management and Budget (OMB) based on prior year actual awards.[23]

IRC § 7623 authorizes awards for detecting "underpayment of tax" or violations of the "internal revenue laws" "in cases where such expenses are not otherwise provided for by law." Thus, the IRS's position is that IRC § 7623 does not permit awards for recovered FBAR penalties, which are not derived from violations of the internal revenue laws and for which an award provision exists under Title 31.[24] The Tax Court, while it has been presented with the issue, has not decided whether the IRS's position is correct.[25] In the Tax Court case in which the issue arose, a whistleblower sought to recover an award under IRC § 7623(b) for recovered FBAR penalties. When informed of the IRS's position that FBAR proceeds are not the subject of an award under IRC § 7623, the whistleblower viewed the communication as a de facto denial of his claim, arguing to the court that "[b]ecause the bulk of the proceeds collected from Taxpayer 1 consisted of FBAR payments for violation of title 31…there was nothing meaningful left for the Office [IRS Whistleblower Office] to investigate with respect to this claim."[26] The court held that the communications from the IRS did not constitute a "determination regarding an award" within the meaning of IRC § 7623(b)(4) sufficient to confer jurisdiction on the court and thus did not address the issue of whether FBAR penalties are "collected proceeds."[27]

Protection of Taxpayer Information

IRC § 6103 generally prohibits IRS employees from disclosing a taxpayer's "return" or "return information," and civil and criminal penalties are imposed for violating the bar.[28] Form 8938, which is filed with the tax return, qualifies as "return" or "return information."[29]

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21 *See* PMTA 2012-10 (Apr. 23, 2012) (noting "amounts paid as BSA penalties should be deposited into Treasury's General Fund). *See* GAO, 2 *Principles of Federal Appropriations Law* 6-166 – 6-175 (3d ed. 2006) (agencies must deposit into the General Fund of the Treasury any funds received from sources outside the agency absent statutory authority to retain the funds or deposit them elsewhere). Once these amounts go into the General Fund, only a specific appropriation can get them out. See *id*. at 6-168 – 6-169." *See also* OMB Circular No. A–11, *Section 20 Terms and Concepts* 3 (noting "[a]ppropriation means a provision of law… authorizing the expenditure of funds for a given purpose").

22 IRS Whistleblower Officer (WO) response to TAS information request (Aug. 26, 2015).

23 *See* OMB Circular No. A–11, *Section 20 Terms and Concepts* 3, noting "[a]pportionment is a plan, approved by OMB, to spend resources provided by one of the annual appropriations acts, a supplemental appropriations act, a continuing resolution, or a permanent law (mandatory appropriations)"; Internal Revenue Manual (IRM) 25.2.2.13, *Award Payment Procedures* (Aug. 7, 2015).

24 See PMTA 2012-10 (Apr. 23, 2012).

25 *Whistleblower 22231-12W v. Comm'r*, T.C. Memo. 2014-157 (2014).

26 *Id*. slip op. at 6-7.

27 *Id*.

28 IRC § 6103 (a); IRC §§ 7431, 7213, 7213A.

29 IRC § 6103(b)(1) defines "return" as "any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed." IRC § 6103(b)(2)(A) defines "return information" to include "a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense."

The status of information the IRS gathers in an FBAR investigation under IRC § 6103 is not as straightforward, and stems from rules pertaining to how the IRS may access Title 26 information during a Title 31 investigation. IRC § 6103(h)(1) permits the IRS to share returns and return information with Department of Treasury employees "whose official duties require such inspection or disclosure for tax administration purposes." IRC § 6103(b)(4) defines "tax administration" as including "the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or *related statutes*" (emphasis added). Thus, if the IRS determines that a Title 31 investigation is considered to be tax administration under the "related statute" portion of the definition of tax administration, IRS employees are authorized to access returns or return information in conducting a Title 31 investigation.[30] It follows, according to IRS Chief Counsel guidance, that "information collected or generated in that [Title 31] investigation after the related statute call has been made is protected by section 6103."[31] However, if in a particular case Title 31 is not a related statute (*e.g.*, because there are no possible Title 26 violations), the information would not be return information under IRC § 6103.[32]

Exceptions to the general rule of nondisclosure in IRC § 6103 permit the IRS to disclose a taxpayer's return or return information to a whistleblower in limited circumstances and for specific purposes. For example, IRC § 6103(h)(4) permits the IRS to disclose, to the extent necessary, a taxpayer's return information to a whistleblower in a whistleblower administrative proceeding.[33] The preliminary award the IRS communicates to the whistleblower includes "a summary report that states a preliminary computation of the amount of collected proceeds, the recommended award percentage, the recommended award amount… and a list of the factors that contributed to the recommended award percentage."[34] The National Taxpayer Advocate has noted that existing procedures do not protect taxpayers from re-disclosure of their confidential information by whistleblowers and has recommended corrective legislation.[35]

Whether or not they qualify as "return" or "return information," FBARs and information derived or extracted from FBARs are not subject to disclosure under the Freedom of Information Act.[36] FBARs

30 *See* IRM 4.26.14.2, *Access to Title 26 Returns and Return Information* (July 24, 2012) (providing guidance on "related statute" determinations). Moreover, according to IRM 4.26.17.2(1)(d), *FBAR Procedures Starting the Case - Related Statute Memorandum* (Jan. 1, 2007), "[i]f the source of the FBAR information is a Title 26 examination… the information acquired is return information protected by IRC Section 6103. The examiner must obtain a related statute determination, signed by a Territory Manager before using the return information in an FBAR case." The IRM does not specify what the "source" of the FBAR information is where a whistleblower provides information that leads to a Title 26 examination.

31 IRS Chief Counsel, Procedure and Administration, Publication 4639, *Disclosure & Privacy Law Reference Guide* (Rev. 10-2012) 7-5. An accompanying note advises "[a]lthough there are no cases addressing the related statute determination, there are cases suggesting that a money laundering charge, standing alone, is not 'tax administration.' *See United States v. Hobbs*, 991 F.2d 569, 573 (9th Cir. 1993); *United States v. Callahan*, 981 F.2d 491, 494 n.3 (11th Cir. 1993), *cert. denied*, 508 U.S. 976 (1993)."

32 *See* IRM 4.26.17.2.3, *Cases Where No Related Statute Memorandum (RSM) Needed* (May 5, 2008) (noting "[i]f the examiner is conducting an examination under the BSA, a related statute determination is not needed to examine for FBAR compliance. This is because no information from a tax examination or other 6103 protected source is involved.").

33 IRC § 6103(h)(4); Treas. Reg. § 301.6103(h)(4)-1.

34 Treas. Reg. § 301.7623–3(c)(2)(ii) (regarding preliminary awards under IRC § 7623(b)). *See* Treas. Reg. § 301.7623-3(b)(1) (regarding a similar provision for preliminary awards under IRC § 7623(a)).

35 *See* Most Serious Problem: *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*, *supra*; Legislative Recommendation: *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 Requirements of IRC § 6103(p)*, *supra*.

36 31 U.S.C. § 5319 provides that FBARs are exempt from disclosure under the Freedom of Information Act (5 U.S.C. § 552) and "may not be disclosed under any State, local, tribal, or territorial 'freedom of information,' 'open government,' or similar law." *See Berger v. I.R.S.*, 487 F. Supp. 2d 482, 496 (D.N.J. 2007) *aff'd*, 288 F. App'x 829 (3d Cir. 2008) (holding the IRS was not required to disclose information derived or extracted from BSA reports).

may be disclosed at the discretion of the Secretary, but guidelines issued pursuant to this authority do not specifically contemplate IRS disclosures of FBAR information to whistleblowers.[37]

REASONS FOR CHANGE

The FATCA and FBAR statutory regimes allow the IRS to recover penalties against taxpayers who fail to report the same foreign bank account, an outcome about which the National Taxpayer Advocate has significant concerns. However, once the IRS actually collects both penalties on the basis of information provided by a whistleblower, it is anomalous to pay awards to whistleblowers with respect to recovered FATCA penalties but not recovered FBAR penalties. Moreover, information from whistleblowers may be the *only* way for the IRS to learn of foreign accounts that do not meet the FATCA third-party reporting thresholds or those that exceed the FATCA reporting thresholds but escape third-party reporting. As the whistleblower in one Tax Court case asserted, FBAR penalties may far exceed amounts recovered under Title 26.[38] Thus, whistleblowers would have more of an incentive to report undetected foreign bank accounts if FBAR penalties were included in the award amount.

Information the IRS collects as part of an FBAR investigation may not constitute "return" or "return information" under IRC § 6103, but may nevertheless be unavailable to a whistleblower pursuant to nondisclosure provisions of Title 31. To the extent a whistleblower cannot access information the IRS obtains in the course of an FBAR investigation, he or she may not be able to effectively challenge the IRS's determination about the amount of a proposed award that stems from collected FBAR penalties.[39] The proposal to include FBAR proceeds in whistleblower awards necessitates additional proposals to allow the IRS to disclose FBARs and information the IRS receives in ascertaining a taxpayer's liability for FBAR violations to whistleblowers and to simultaneously ensure the confidentiality of that information. Designating such information as return or return information within the meaning of IRC § 6103, subject to the same limitations on disclosure and making whistleblowers subject to existing penalties for violating IRC § 6103, would accomplish both objectives.

EXPLANATION OF RECOMMENDATIONS

The proposal would:

- Amend IRC § 7623 to include collected FBAR penalties in the definition of "proceeds of amounts collected" and "collected proceeds;"
- Designate FBARs and information the IRS receives in ascertaining a taxpayer's liability for FBAR violations as return or return information within the meaning of IRC § 6103; and
- Make whistleblowers subject to existing penalties for the unauthorized use or re-disclosure of such information.

37 31 C.F.R. § 1010.950 provides "[t]he Secretary may within his discretion disclose information reported under this chapter for any reason consistent with the purposes of the Bank Secrecy Act." According to IRM Exhibit 4.26.14-3, *Re-Dissemination Guidelines for Bank Secrecy Act Information*, Section VI (July 24, 2012), the IRS may not disseminate BSA information without the consent of FinCEN in the absence of exceptions that would not apply to whistleblowers. *See also* IRM Exhibit 4.26.14-2, *Memorandum of Understanding Between the FinCEN and the IRS dated Sept. 24, 2010* (July 24, 2012) (including FBARs in the definition of BSA information).

38 *Whistleblower 22231-12W v. Comm'r*, T.C. Memo. 2014-157 (2014), slip op. at 6-7.

39 *See, e.g.*, *Berger v. I.R.S.*, 487 F. Supp. 2d 482, 496 (D.N.J. 2007) *aff'd*, 288 F. App'x 829 (3d Cir. 2008) (rejecting the contention that the IRS, based on IRM provisions, had discretion to release information it obtained in a Title 31 investigation).

The proposal would lead to consistent treatment, for whistleblower award purposes, of recovered FATCA and FBAR penalties, supporting the *right to a fair and just tax system*. The proposal would strengthen the right to be heard and the right to confidentiality by:

- Clearly bringing within the ambit of IRC § 6103 information the IRS obtains as part of its FBAR investigation without the need for a "related statute" determination; and
- Allowing the IRS to share that information pursuant to exceptions of IRC § 6103, which in turn would permit whistleblowers to make an informed decision about whether to challenge a proposed whistleblower award; yet
- Adopting measures to prevent whistleblowers from re-disclosing that information.

The proposal would also provide incentive to whistleblowers to report foreign accounts that are likely to escape detection by the IRS.

INTRODUCTION: Most Litigated Issues

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(X) requires the National Taxpayer Advocate to identify in her Annual Report to Congress (ARC) the ten tax issues most litigated in federal courts (Most Litigated Issues).[1] The National Taxpayer Advocate may analyze these issues to develop recommendations to mitigate the disputes resulting in litigation.

TAS identified the Most Litigated Issues (MLI) from June 1, 2014, through May 31, 2015, by using commercial legal research databases. For purposes of this section of the Annual Report, the term "litigated" means cases in which the court issued an opinion.[2] This year's MLI are:

- Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2);[3]
- Trade or Business Expenses Under IRC § 162 and Related Sections;
- Summons Enforcement Under IRC §§ 7602, 7604, and 7609;
- Gross Income Under IRC § 61 and Related Sections;
- Appeals from Collection Due Process (CDP) Hearings Under IRC §§ 6320 and 6330;
- 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;
- Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403;
- Charitable Deductions Under IRC § 170;
- Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions; and
- Relief from Joint and Several Liability Under IRC § 6015.

All of these issues were identified as MLIs last year, with the exception of relief from joint and several liability for spouses.[4] This issue has appeared in previous MLI sections, most recently in 2013.[5] Accuracy-related penalties remained the top issue this year, although we identified 40 fewer cases than the 153 cases identified last year.[6] This works out to a 26 percent decrease, the largest drop in any category of cases. Summons enforcement cases experienced the second largest percentage decrease, as we identified 84 cases this year and 102 last year, an 18 percent decrease.[7] Cases involving civil actions to enforce federal tax liens or to subject property to payment of tax and trade or business expenses also decreased from previous

1 Federal tax cases are tried in the United States Tax Court, United States District Courts, the United States Court of Federal Claims, United States Bankruptcy Courts, United States Courts of Appeals, and the United States Supreme Court.

2 Many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers' cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Courts can issue less formal "bench opinions," which are not published or precedential.

3 IRC § 6662 also includes (b)(4), (5), (6), and (7), but because those types of accuracy-related penalties were not heavily litigated, we have only analyzed (b)(1), (2), and (3).

4 *See* National Taxpayer Advocate 2014 Annual Report to Congress 423.

5 *See* National Taxpayer Advocate 2013 Annual Report to Congress 322.

6 *See* National Taxpayer Advocate 2014 Annual Report to Congress 443.

7 *Id*. at 462.

year figures by 15 percent and 14 percent, respectively.[8] Overall, the total number of cases identified in the MLIs dropped from 731 in 2014 to 640 this year, a 12 percent decrease from last year and a 27 percent decrease from the 877 cases identified in 2013.[9] Although there has been a decline in the number of cases over the last two years, the relative percentage of cases involving *pro se* taxpayers has remained consistent, with 62 percent this year, as compared to the same percentage last year and 63 percent in 2013.[10]

Once TAS identified the MLI, we analyzed each one in five sections: summary of findings, taxpayer rights impacted, description of present law, analysis of the litigated cases, and conclusion. The taxpayer rights impacted section is new for the MLIs section this year and reflects the relevance of the Taxpayer Bill of Rights (TBOR), which was adopted by the IRS last year on the National Taxpayer Advocate's recommendation.[11] Each case is listed in Appendix 3, which categorizes the cases by type of taxpayer (*i.e.*, individual or business).[12] Appendix 3 also provides the citation for each case, indicates whether the taxpayer was represented at trial or argued the case *pro se* (*i.e.*, without representation), and lists the court's decision.[13]

We have also included a "Significant Cases" section summarizing decisions that are not among the top ten issues but are relevant to tax administration.[14] This year, the Significant Cases discussion includes two decisions issued by the Supreme Court that impact tax adminstration issues and a circuit court of appeals decision that directly affects TAS.[15]

AN OVERVIEW OF HOW TAX ISSUES ARE LITIGATED

Taxpayers can generally litigate a tax matter in four different types of courts:

- The United States Tax Court;
- United States District Courts;
- The United States Court of Federal Claims; and
- United States Bankruptcy Courts.

8 *See* National Taxpayer Advocate 2014 Annual Report to Congress 503; National Taxpayer Advocate 2014 Annual Report to Congress 453.

9 *Id*. at 425; National Taxpayer Advocate 2013 Annual Report to Congress 324.

10 *Id.*

11 *See* TBOR, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights; National Taxpayer Advocate 2013 Annual Report to Congress 5 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

12 Individuals filing Schedules C, E, or F are deemed business taxpayers for purposes of this discussion even if items reported on such schedules were not the subject of litigation.

13 "*Pro se*" means "for oneself; on one's own behalf; without a lawyer." Black's Law Dictionary (10th ed. 2014). For purposes of this analysis, we considered the court's decision with respect to the issue analyzed only. A "split" decision is defined as a partial allowance on the specific issue analyzed. The citations also indicate whether decisions were on appeal at the time this report went to print.

14 Three of the cases discussed in the "Significant Cases" section of this report were decided outside the June 1, 2014, through May 31, 2015, period used to identify the ten most litigated issues, but we nonetheless have included these cases because of their impact on tax administration.

15 *King v. Burwell*, 135 S. Ct. 2480 (June 25, 2015), *aff'g* 759 F.3d 358 (4th Cir. 2014), *aff'g sub. nom. King v. Sebelius*, 997 F. Supp. 2d 415 (E.D. Va. 2014); *Obergefell v. Hodges*, 135 S. Ct. 2584 (June 26, 2015); *Rothkamm v. U.S.*, No. 14-31164, slip op. (5th Cir. 2015), — F.3d —, 116 A.F.T.R. 2d 2015-6198 (2015), *rev'g and remanding*, 114 A.F.T.R. 2d (RIA) 5997, 2014-2 U.S. Tax Cas. (CCH) P50,441 (M.D. La. 2014).

With limited exceptions, taxpayers have an automatic right of appeal from the decisions of any of these courts.[16]

The Tax Court is a "prepayment" forum. In other words, taxpayers can access the Tax Court without having to pay the disputed tax in advance. The Tax Court has jurisdiction over a variety of issues, including deficiencies, certain declaratory judgment actions, appeals from CDP hearings, relief from joint and several liability, and determination of employment status.[17]

The United States District Courts and the United States Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full,[18] and (2) the taxpayer has filed an administrative claim for refund.[19] The United States District Courts, along with the bankruptcy courts in very limited circumstances, provide the only fora in which a taxpayer can receive a jury trial.[20] Bankruptcy courts can adjudicate tax matters that were not adjudicated prior to the initiation of a bankruptcy case.[21]

16 *See* IRC § 7482, which provides that the United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) have jurisdiction to review the decisions of the Tax Court. There are exceptions to this general rule. For example, IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals $50,000 or less) for which appellate review is not available. *See also* 28 U.S.C. § 1294 (appeals from a United States District Court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court). *See also Byers v. Comm'r*, 740 F.3d 668 (D.C. 2014), *cert. denied*, 83 U.S.L.W. 3189 (U.S. Oct. 6, 2014) (No. 14-74) (the D.C. Circuit will not transfer cases to another circuit in non-liability CDP cases unless both parties stipulate to transfer the case).

17 IRC §§ 6214; 7476-7479; 6330(d); 6015(e); 7436.

18 28 U.S.C. § 1346(a)(1). *See Flora v. United States*, 362 U.S. 145 (1960), *reh'g denied*, 362 U.S. 972 (1960).

19 IRC § 7422(a).

20 The bankruptcy court may only conduct a jury trial if the right to a trial by jury applies, all parties expressly consent, and the district court specifically designates the bankruptcy judge to exercise such jurisdiction. 28 U.S.C. § 157(e).

21 *See* 11 U.S.C. §§ 505(a)(1) and (a)(2)(A).

ANALYSIS OF *PRO SE* LITIGATION

As in previous years, many taxpayers appeared before the courts *pro se*. Figure 3.0.1 lists the Most Litigated Issues for the review period June 1, 2014, through May 31, 2015, and identifies the number of cases, categorized by issue, in which taxpayers appeared without representation. As the figure illustrates, the issues with the highest rates of *pro se* appearance are summons enforcement and the frivolous issues penalty.

FIGURE 3.0.1, *Pro Se* Cases by Issue

Most Litigated Issue	Litigated Cases Reviewed	*Pro Se* Litigation	% of Cases Involving *Pro Se* Taxpayers
Accuracy-Related Penalty	113	68	60%
Trade or Business Expenses	99	60	61%
Summons Enforcement	84	61	73%
Gross Income	80	53	66%
Collection Due Process	79	46	58%
Failure to File, Failure to Pay, and Estimated Tax Penalties	63	41	65%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	44	18	41%
Charitable Deductions	28	14	50%
Frivolous Issues Penalty (and analogous appellate-level sanctions)	26	24	92%
Relief From Joint and Several Liability	24	11	46%
Total	**640**	**396**	**62%**

Figure 3.0.2 affirms our contention that taxpayers are more likely to prevail if they are represented. The disparity in the success rate between *pro se* and represented taxpayers is much less than last year. *Pro se* taxpayers prevailed in 19 percent of cases this year as compared to ten percent last year, a remarkable 90 percent increase in success rate. Represented taxpayers fared slightly better than last year, achieving a 28 percent success rate as compared to 26 percent last year, an eight percent increase.

FIGURE 3.0.2, Outcomes for *Pro Se* and Represented Taxpayers

	Pro Se Taxpayers			Represented Taxpayers		
Most Litigated Issue	Total Cases	Taxpayer Prevailed in whole or in part	Percent	Total Cases	Taxpayer Prevailed in whole or in part	Percent
Accuracy-Related Penalty	68	14	21%	45	12	27%
Trade or Business Expenses	60	23	38%	39	19	49%
Summons Enforcement	61	1	2%	23	2	9%
Gross Income	53	7	13%	27	10	37%
Collection Due Process	46	5	11%	33	9	27%
Failure to File, Failure to Pay, and Estimated Tax Penalties	41	7	17%	22	4	18%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	18	0	0%	26	4	15%
Charitable Contributions	14	5	36%	14	5	36%
Frivolous Issues Penalty (and analogous appellate-level sanctions)	24	7	29%	2	0	0%
Relief From Joint and Several Liability	11	5	45%	13	4	31%
Total	**396**	**74**	**19%**	**244**	**69**	**28%**

SIGNIFICANT CASES

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.[1] These decisions are summarized below.

In *King v. Burwell*, the Supreme Court upheld Treasury regulations that provide a Premium Tax Credit to individuals who obtain health insurance through a federally-facilitated exchange.[2]

Virginia residents who did not want to purchase health insurance or pay a penalty (under Internal Revenue Code (IRC) § 5000A) filed suit. They challenged the validity of Treasury Regulations that grant a health insurance Premium Tax Credit, as applied to residents of states that did not set up their own exchanges.[3] If the regulations were invalid, the plaintiffs would be ineligible for the credit. Without the credit, the plaintiffs would not be required to purchase insurance because they would qualify for the exception applicable to low income taxpayers without access to affordable insurance.[4]

By statute, the Premium Tax Credit is only available to offset premiums available "through an Exchange established by the State."[5] The Commonwealth of Virginia has not established a state-run health insurance exchange and is therefore served by the federally-facilitated exchange (*i.e.*, HealthCare.gov). The plaintiffs allege that the related regulations are invalid because they authorize credits not only for people using "an Exchange established by the State," but also for people using the federally-facilitated exchange.[6]

The district court upheld the regulations and granted the government's motion to dismiss.[7] The United States Court of Appeals for the 4th Circuit affirmed, citing *Chevron*.[8] Under *Chevron*, courts generally defer to an agency's interpretation of ambiguous statutory language.[9]

The Supreme Court affirmed but did not defer to the IRS under *Chevron*. It concluded that the statutory language was ambiguous, but that Congress did not intend to delegate a decision of such deep "economic

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2014, and ending on May 31, 2015. For purposes of this section, we generally used the same period, except that we included two Supreme Court decisions issued shortly thereafter and one circuit court decision that directly affects TAS.

2 *King v. Burwell*, 135 S. Ct. 2480 (June 25, 2015), *aff'g* 759 F.3d 358 (4th Cir. 2014), *aff'g sub. nom. King v. Sebelius*, 997 F. Supp. 2d 415 (E.D. Va. 2014).

3 *See generally* Treas. Reg. § 1.36B–2.

4 Low income individuals for whom the annual "cost of coverage" exceeds eight percent of their projected household income are not subject to a penalty for failing to purchase health insurance. IRC § 5000A(e)(1)(A). Under this rule, the cost of coverage may be reduced by the Premium Tax Credit. IRC § 5000A(e)(1)(B)(ii).

5 IRC §§ 36B(b)(2), 36B(c)(2)(A)(i).

6 Treas. Reg. § 1.36B–2 provides that credits shall be available to anyone "enrolled in one or more qualified health plans through an Exchange," and Treas. Reg. § 1.36B-1(k) adopts, by cross-reference, a Health and Human Services (HHS) definition of "Exchange" that includes any Exchange, "regardless of whether the Exchange is established and operated by a State … or by HHS." 45 C.F.R. § 155.20.

7 *King v. Burwell*, 997 F. Supp. 2d 415 (E.D. Va.2014).

8 *King v. Burwell*, 759 F.3d 358 (4th Cir. 2014).

9 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). On the same day that the 4th Circuit issued its opinion, a panel of the Court of Appeals for the District of Columbia Circuit struck down the regulations, creating a split among the circuits. *Halbig v. Burwell*, 758 F.3d 390 (D.C. Cir. 2014). The Court of Appeals for the District of Columbia later agreed to rehear the case *en banc* and vacated its original decision eliminating the split. *Halbig v. Burwell*, 114 A.F.T.R.2d (RIA) 5868 (2014).

and political significance" to the IRS.[10] Additionally, it noted that the IRS had no particular expertise in crafting health insurance policy to which courts should defer.

Instead, the Court searched for a meaning compatible with the structure and purpose of the law. It noted that the petitioner's literal interpretation could result in the failure of the legislation. It found that Congress intended the Premium Tax Credit to apply broadly, to both state and federal exchanges to maximize insurance coverage. The Court therefore held that Premium Tax Credits are available to individuals purchasing insurance through the federally-facilitated exchange.[11]

This case is significant because those purchasing health insurance through the federally-facilitated exchange will continue to receive tax credits. It is also significant because the Court suggested that Treasury Regulations may not be entitled to *Chevron* deference when they interpret the ACA or other important non-tax laws in areas where the IRS does not have substantive expertise.

In *Obergefell v. Hodges*, the Supreme Court held that states must allow same-sex couples to marry and recognize same-sex marriages performed in other states.[12]

Various district courts held that the state laws in Michigan, Tennessee, Ohio, and Kentucky, which defined marriage as between one man and one woman, violated the U.S. Constitution. The U.S. Court of Appeals for the 6th Circuit consolidated these cases and reversed, upholding the state laws. The Supreme Court reversed, holding that the states cannot "exclude same-sex couples from civil marriage on the same terms and conditions as opposite sex couples"[13] and that states must recognize same-sex marriages performed in other states.

Although same-sex married couples have been treated as married for federal income tax purposes since the Court held the Defense of Marriage Act (DOMA) unconstitutional,[14] this case is significant to federal income tax administration because it affects marital status, parentage, income, property rights, insurance coverage, and state taxes, all of which are reported on federal returns. Couples in common-law marriage states may find themselves legally married on a retroactive basis. For those in community property states, the holding may affect their taxable income for both state and federal income tax purposes, even if they file separately.[15] Determining the parentage of children for federal tax purposes may now be less complicated. These issues may prompt some to amend their federal or state returns. Even those who only amend state returns to change their filing status may also amend their federal returns for consistency (*e.g.*, to adjust their deduction for state and local taxes). While this case should generally simplify tax filing,

10 *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015).

11 As the Court based its decision on its interpretation of the statute, it would be difficult for the IRS to issue regulations that would reinterpret the statue any other way. *See National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967 (2005) (suggesting agencies may not adopt a statutory interpretation rejected by the courts).

12 *Obergefell v. Hodges*, 135 S. Ct. 2584 (June 26, 2015).

13 *Id*. at 2605.

14 *U.S. v. Windsor*, 133 S. Ct. 2675 (2013); Rev. Rul. 2013-17, 2013-38 I.R.B. 201. After *Windsor*, the IRS allowed but did not require retroactive joint filing. Rev. Rul. 2013-17, 2013-38 I.R.B. 201. For a discussion of *Windsor* and related tax issues, see, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress 326-27 (discussing *Windsor*), National Taxpayer Advocate 2013 Annual Report to Congress (Most Serious Problem: *Domestic Partners and Same-Sex Couples Need Federal Tax Guidance*), and National Taxpayer Advocate 2012 Annual Report to Congress 449 (Status Update: *Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses*).

15 Even if married taxpayers file separately, each is generally subject to tax on one-half of any "community income," including income earned by his or her spouse. *See Poe v. Seaborn*, 282 U.S. 101 (1930). Married taxpayers in community property states have "community income" under state law.

there is a long list of state tax issues that will need to be resolved.[16] In addition, the Solicitor General suggested that if the Court held the state laws unconstitutional, as it did, "the tax exemptions of some religious institutions would be in question if they opposed same-sex marriage."[17] Representatives in Congress are reportedly working to address this issue.[18]

In *Rothkamm v. United States*, the United States Court of Appeals for the 5th Circuit held that the period of limitations for filing a wrongful levy claim was suspended by a person's application for a Taxpayer Assistance Order (TAO).[19]

On March 6, 2012, the IRS issued a notice of levy to Mrs. Rothkamm's bank, seeking to collect her husband's tax liability from an account she claimed was her separate property. On April 18, 2012, the bank complied with the levy, transferring the proceeds of her account to the IRS. About two weeks later, on April 30, 2012, she sought assistance from the Taxpayer Advocate Service (TAS), filing a Form 911, *Application for a Taxpayer Assistance Order*. About five and a half months later, on October 11, 2012, TAS closed her case.[20] On May 15, 2013, more than nine months following the levy, Mrs. Rothkamm filed an administrative claim for wrongful levy under IRC § 6343(b).[21] The IRS denied the claim on July 1, 2013. Finally, on September 6, 2013, Mrs. Rothkamm filed a suit for wrongful levy under IRC § 7426(a). The district court held her claim was time barred, but the United States Court of Appeals for the 5th Circuit reversed and remanded.

A person generally must file any administrative claim with the IRS for wrongful levy within nine months of the levy.[22] A person may also file suit for wrongful levy in district court within the same nine-month period.[23] However, a timely filed administrative claim tolls the nine-month period for filing a suit by up to 12 months — the shorter of 12 months from the administrative filing or six months from the date the IRS mails a notice of disallowance.[24]

16 Some same-sex married couples had to file as unmarried for state tax purposes, even on returns that required figures from a federal return. To arrive at the figures needed to fill out the state returns, taxpayers sometimes had to compute "dummy" federal returns that they would not file. *See* Intuit, *Simplifying the Tax Filing Process for Same-Sex Couples* (June 19, 2015), *available at* http://intuittaxandfinancialcenter.com/article/simplifying-the-tax-filing-process-for-same-sex-couples/. These filing burdens, which were particularly severe for those with interests in flow-through entities doing business nationwide, should decrease as a result of this decision.

17 *Obergefell v. Hodges*, 135 S. Ct. 2584, 2626 (June 26, 2015) (J. Roberts, Dissenting).

18 *See, e.g.*, Kaustuv Basu, *Lee's Bill Would Protect Tax-Exempt Status for Religious Groups*, 147 Tax Notes 1138 (June 8, 2015); First Amendment Defense Act, S.1598, 114th Cong. (2015).

19 *Rothkamm v. U.S.*, 802 F.3d 699 (5th Cir. 2015) (hereinafter *Rothkamm II*), *rev'g and remanding*, 114 A.F.T.R. 2d (RIA) 5997, 2014-2 U.S. Tax Cas. (CCH) P50,441 (M.D. La. 2014) (hereinafter *Rothkamm I*).

20 The 5th Circuit Court's dissenting opinion noted that "Rothkamm has not argued that TAS did not inform her about the period of limitation for filing a wrongful levy action." *Rothkamm II* at 718 n. 22.

21 Mrs. Rothkamm filed her administrative claim more than 14 months after the March 6, 2012, notice of levy and nearly 13 months after the bank paid the levy on April 18, 2012.

22 IRC § 6343(b); Treas. Reg. § 301.6343–2(a)(2).

23 IRC §§ 7426(a) and (i) (cross referencing IRC § 6532(c)).

24 IRC § 6532(c)(2); Treas. Reg. § 301.6532–3.

The government first argued that Mrs. Rothkamm's suit was time barred because her nine–month period for filing a wrongful levy suit expired on January 18, 2013.[25] Thus, her suit, filed September 6, 2013, was over seven months late.

Mrs. Rothkamm argued that her suit was timely because the nine-month period for bringing a wrongful levy suit was suspended during the pendency of both: (1) her April 18, 2012 application for a TAO (under IRC § 7811(d)); *and* (2) her timely administrative claim to the IRS filed on May 15, 2013.[26] She reasoned that her TAO application extended the deadline for filing an administrative claim by over five months. Because of this extension, her administrative claim was timely and it extended the period for filing suit until six months after the IRS disallowed it on July 1, 2013 (*i.e.*, until January 1, 2014). Thus, Mrs. Rothkamm's September 6, 2013 suit was timely.

By its terms, IRC § 7811(d) suspends "[t]he running of any period of limitation with respect to any action described in subsection (b) [the terms of a TAO]." IRC § 7811(b) provides:

> The terms of a Taxpayer Assistance Order may require the Secretary within a specified time period — (1) to release property of the taxpayer levied upon, or (2) to cease any action, take any action as permitted by law, or refrain from taking any action, with respect to the taxpayer…

The government argued and the district court agreed that (1) the tolling provided by IRC § 7811(d) only applies to "taxpayers" and that Mrs. Rothkamm was not a "taxpayer" for that purpose, and (2) even if Mrs. Rothkamm *was* a taxpayer, she was not entitled to tolling because it only applies to IRS actions, not taxpayer actions.[27] Thus, the district court concluded it had no subject matter jurisdiction because the claim was not timely.

First, the 5th Circuit concluded that the district court erred by failing to use the definition of "taxpayer" set forth in IRC § 7701(a)(14), which includes "any person subject to any internal revenue tax." It relied on the Supreme Court decision in *Williams*, which held that Lori Williams, "who paid a tax under protest to remove a lien on her property," was a taxpayer under IRC § 7701(a)(14), and therefore, "had standing to bring a refund action under 28 USC § 1346(a)(1), even though the tax she paid was assessed against a third party."[28] The court rejected the government's argument that subsequent case law had altered the Supreme Court's interpretation of IRC § 7701(a)(14).[29]

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25 *Rothkamm I*, slip op. at *2 (referencing the January 18 deadline); Govt. Motion to Dismiss, Dkt. No. 3:13-cv-00589-BAJ-RLB 2 (M.D. La., Nov. 8, 2013) (same). If the nine-month period for filing a wrongful levy claim did not begin until the bank *paid* the levy it would have expired on January 18, 2013, but if it began when the IRS *issued* the notice of levy to the bank it would have expired on December 6, 2012. In other cases cited by the court, and on appeal, the government argued that the period begins on the date the IRS *issues* the notice of levy. *See, e.g.*, Brief for the Appellees, Dkt. No. 14-31164 at 15 (Feb. 2, 2015) (referencing the December 6, 2012 deadline); *United Sand & Gravel Contractors, Inc. v. U.S.*, 624 F.2d 733, 735 (5th Cir.1980) (treating the date of the notice of levy as the date of the levy); Treas. Reg. § 301.6532–3(c)(Ex. 1) (same for notice of seizure).

26 *Rothkamm I*, slip op. at *2. Regulations make clear that wrongful levy claims must be filed with a specific office. Treas. Reg. § 301.6343–2(b). In other cases; however, taxpayers appear to have argued that submissions to TAS were informal claims. *See, e.g.*, *John Purciello v. U.S.*, No. 2:11-cv-4181(DMC)(MF), 2013 WL 6448108 (D.N.J. Dec. 9, 2013). Even if the April 30, 2012, application for a TAO was treated as an informal claim, in the absence of additional tolling, the period for filing suit would arguably have expired 12 months later, on April 30, 2013, and the May 15, 2013 filing may still have been late.

27 *Rothkamm I,* slip op. at *2.

28 *Rothkamm II* at 704 (quoting *U.S. v. Williams*, 514 U.S. 527, 529 (1995)).

29 The government cited *EC Term of Years Trust v. U.S.*, 550 U.S. 429 (2007), which held a court had no jurisdiction to hear a claim for wrongful levy by a trust under 28 U.S.C. 1346(a)(1). The 5th Circuit explained that if the trust could bring suit under IRC § 1346(a)(1), its suit would be timely, but it would be time-barred under IRC § 7426(a)(1)'s stricter nine-month statute of limitations. Therefore, *EC Terms of Years Trust* concerned the remedy available to the trust and had no bearing on whether the trust was a taxpayer.

The 5th Circuit found no reason to conclude that the definition of taxpayer in IRC §§ 7811 or 7803 is different from the general definition of taxpayer found in IRC § 7701(a)(14), observing that at least four of the ten examples of TAOs set forth in regulations involve wrongful levies, and speculating that some of them could have been referring to third parties.[30] It held that the term "taxpayer" in IRC § 7811 includes not only the person against whom a tax is assessed, but also the person who actually pays the tax. Thus, the tolling provisions under IRC § 7811 could apply to Mrs. Rothkamm.

Next, the 5th Circuit rejected the argument that tolling only applies to actions of the IRS. IRC § 7811(d) says tolling applies to "any statute of limitations for any action described in § 7811(b)." The court suggested that tolling applied because "release[ing] property of the taxpayer levied upon," which was at issue in Mrs. Rothkamm's case, is described in IRC § 7811(b)(1).

Because the court's holding was based on the plain language of the statute under *Chevron* step-one,[31] it gave no deference to regulations which state "[A] taxpayer's right to administrative or judicial review will not be diminished or expanded in any way as a result of the taxpayer's seeking assistance from TAS."[32] It nonetheless reasoned that tolling would allow a taxpayer to pursue a TAO without fear that the process would prejudice her rights in the event she does not obtain TAO relief, claiming that its interpretation would not make the IRS or the taxpayer any worse off.[33]

Finally, the 5th Circuit concluded that neither the code nor the regulations make tolling subject to the IRS's discretion, dismissing contrary authorities.[34] It also dismissed the government's statutory arguments. The government apparently argued that Congress directly addressed the question of whether IRC § 7811(d) tolls the running of the nine-month statute of limitations in IRC § 7426(a) because neither statute references the other. According to the court, the government failed to explain how Congress may directly address something by remaining silent on it.[35] The government's other statutory argument was that tolling does not apply to the release of levies under IRC § 7811(b)(1) because that section does not contain the word "action." The court determined that this argument had no merit.[36] It noted that the government had offered no reasonable alternative construction of the plain language

30 *Rothkamm II* at 708 n.29 (citing Treas. Reg. §§ 301.7811-1(a)(Ex. 1), -1(e) (Exs. 1, 2, and 3)).

31 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). A court only gives deference to agency regulations under *Chevron* step-two, if it first determines the statute is ambiguous under *Chevron* step-one. *Id*.

32 Treas. Reg. § 301.7811-1(b). The court also reasoned that this regulation addresses TAOs and not tolling. *Rothkamm II* at 711.

33 *Rothkamm II* at 709-10. Whether tolling the period of limitations for taking an action makes a person better off depends on whether the person is able to take the action during the tolling period. If they are able to take the action, tolling makes them better off because they get a longer period than otherwise provided by statute. For example, if the ten-year period for the IRS to collect tax is extended during the pendency of a TAO application, the IRS is only better off if it could continue to collect during that period. Assuming it could, the IRS could collect for more than ten years otherwise allowed by law. Citing legislative history, instructions to Form 911, and case law, the dissent argues that IRC § 7811(d) tolls the limitations period only with respect to actions of the IRS on the basis that it cannot take action while an application for a TAO is pending. *Rothkamm II* at 717-18. The dissent also cited various cases for the proposition that "all suspension provisions [including § 7811(d)] are designed and intended to avoid prejudice to the IRS's ability to collect during periods of time in which collection or assessment is prohibited by law [or otherwise impeded]." *Id*. at 717 n.14.

34 *Rothkamm II* at 713 (referencing *Demes v. U.S.*, 52 Fed. Cl. 365, 373 (Fed. Cl. 2002)).

35 *Id.* at 713-14.

36 *Id.* Even if the court had accepted the government's argument that tolling under IRC § 7811(d) only covers "actions" under IRC § 7811(b) that are described using the word "action," it would have lost. IRC § 7811(b)(2)(A) specifically refers to "actions" under "chapter 64," and IRC § 6343, which covers wrongful levies, is located in chapter 64. In addition, IRC § 7811(b)(2)(D) refers to "actions" under "any other provision of law which is specifically described by the National Taxpayer Advocate in such order," which may address wrongful levies.

of IRC § 7811(d).[37] Thus, it held that Mrs. Rothkamm's filing was timely because her application for a TAO tolled the period for filing a wrongful levy claim.

This case is significant because it affirms the National Taxpayer Advocate's authority to issue TAOs to assist those who are subject to levies to collect another person's liability. However, it leaves unanswered questions about whether a "taxpayer" includes other third parties, such as whistleblowers or preparers who seek TAOs in situations where they have not been "subject to" the tax at issue in their cases.[38]

As the dissent notes, it is also significant because it creates administrative difficulties, replacing fixed periods of limitation with indefinite periods.[39] The case is likely to prompt many taxpayers who have sought TAS assistance and subsequently missed a deadline to argue that the deadline was tolled under IRC § 7811(d) by their application to TAS. It also raises a number of questions. The IRS has not implemented IRC § 7811(d) because of technical difficulties in recording and tracking the suspension period.[40] Will the IRS now feel obligated to try to implement those provisions, even in cases where they would penalize taxpayers for seeking TAS assistance?[41] Will taxpayers now seek to toll the period for taking "any" action by simply filing a Form 911 (*e.g.*, filing in tax court, requesting a collection due process hearing, claiming a refund).[42] If IRC § 7811(d) tolls the period for taxpayers to take action, can the National Taxpayer Advocate extend these periods even further?[43]

37 The government did not focus on statutory language that supports the position that only actions of the IRS are tolled: IRC § 7811(d) tolls the statute with respect to actions described in IRC § 7811(b), but the flush language of IRC § 7811(b) provides a TAO "may require the Secretary" to take or not take various actions. In other words, all of the actions described in IRC § 7811(b) must be taken by the IRS and not the taxpayer or a third party. Thus, IRC § 7811(d) can only toll the period of limitations with respect to actions of the IRS.

38 For additional discussion of these and other issues, see *Legislative Recommendation: Statute of Limitations: Repeal or Fix Statute Suspension Under IRC § 7811(d)*, *supra*.

39 *Rothkamm II* at 720.

40 Although TAS drafted procedures for implementing statute suspension under IRC § 7811(d), due to technical difficulties, they were not implemented (*e.g.*, tracking different suspension periods for each spouse and for assessments for the same year made on different dates). *See*, *e.g.*, IRM 13.1.14 (Oct. 31, 2004); Memorandum from Commissioner of Internal Revenue, *Taxpayer Advocate Service Statute Suspension Provisions Under IRC Section 7811(d)* (Nov. 10, 2003). At least one legal memo concludes that if the IRS has authority not to implement IRC § 7811(d), it is because the provision can only benefit the IRS by extending the period for the IRS to take enforcement actions (*e.g.*, by extending the period for collection or assessment). *Compare* IRS Litigation Bulletin 360, 1990 WL 1086174, 1990 GLB LEXIS 12 (1990) (concluding that because IRC § 7811(d) only protects the IRS by tolling collection and assessment periods, the IRS is not legally required to implement it), *with* Memo from Acting Counsel to the National Taxpayer Advocate to Director Taxpayer Account Operations, *Suspension of the Statutes of Limitations Under Section 7811(d)* (Mar. 9, 2001) (assuming statute suspension only applies to protect the IRS's interest, but still declining to conclude its implementation is not mandatory).

41 Taxpayers would be penalized if, for example, collection statutes were tolled but collection actions were not suspended.

42 As noted above, *Rothkamm II* did not directly hold that IRC § 7811(d) extended the period for filing suit. Rather, it held that IRC § 7811(d) extended the period for filing an administrative claim, and that the IRS's denial of the timely-filed administrative claim extended the period for filing suit by operation of IRC § 6532(c)(2). A future decision could clarify that IRC § 7811(d) does not extend jurisdictional deadlines for filing in court, but this case still invites litigation in this area. *Compare Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015) (holding the limitations period for filing suit to challenge a wrongful levy was subject to equitable tolling because it was procedural and not jurisdictional, as discussed below) *with Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000) (holding that the limitations period for filing suit to challenge a wrongful levy was jurisdictional, and thus, not subject to equitable tolling).

43 IRC § 7811(d)(2) (tolling the period of limitation with respect to "any action described in subsection (b)" by "any period specified by the National Taxpayer Advocate" in a TAO).

In *Mallo v. IRS*, the United States Court of Appeals for the 10th Circuit held that tax debt with respect to late-filed tax returns (except returns filed with IRS assistance) cannot be discharged in bankruptcy.[44]

The taxpayers did not file timely federal income tax returns for 2000 or 2001. Only after the IRS assessed a tax liability did they file returns.[45] More than two years later, the taxpayers filed for bankruptcy, seeking to discharge their tax debts. The IRS argued the tax debts were not dischargeable. In a consolidated appeal of conflicting decisions, the United States District Court for the District of Colorado agreed with the IRS, as did the United States Court of Appeals for the 10th Circuit.

A taxpayer may not discharge in bankruptcy tax liabilities "with respect to which a return … was not filed or given."[46] Tax liabilities with respect to which a late return was filed within two years of the bankruptcy petition are also exempt from discharge.[47] Before 2005, with certain exceptions, a debtor could discharge the portion of a tax debt that he or she self-assessed on a late return, as long as he or she waited two years after filing. As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Congress attempted to clarify the discharge rules by amending 11 U.S.C. § 523(a) to include a "hanging paragraph."[48] It defines a "return" as "a return that satisfies the requirements of applicable non-bankruptcy law (including applicable filing requirements)." It goes on to state that a late return prepared by the IRS and signed by the taxpayer under IRC § 6020(a) is treated as a return, but a return prepared by the IRS without the taxpayer's cooperation under IRC § 6020(b) is not.[49] Whether a document is a return for tax purposes depends on whether it satisfies the *Beard* test, which requires that it (1) contain sufficient data to calculate tax liability, (2) purport to be a return, (3) be an honest and reasonable attempt to satisfy the law, and (4) be executed under penalties of perjury.[50]

The IRS argued that the tax debt was not dischargeable because it arose from an IRS assessment rather than from a taxpayer's self-assessment on a return. In other words, a debt (or portion thereof) assessed by the IRS before filing was "with respect to which a return … was not filed or given,"[51] and thus, permanently nondischargeable, even if the taxpayer later filed a return. The court rejected this argument, holding that the debt arose from the tax code rather than an assessment.

Instead, the court reasoned that even if a post-assessment filing is a return under *Beard*, late returns are not "returns" for purposes of discharge because they do not satisfy "applicable filing requirements."[52] The taxpayer argued that such an interpretation would make the specific exclusion of late returns filed under IRC § 6020(b) superfluous.[53] The taxpayer also argued that the exclusion for late returns filed less than

44 *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014).

45 Unlike the returns deemed meaningless in *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999), these returns did not mirror the IRS's tax assessment.

46 11 U.S.C. § 523(a)(1)(B)(i).

47 11 U.S.C. § 523(a)(1)(B)(ii).

48 BAPCPA, Pub. L. No. 109-8, § 714, 119 Stat. 23, 128 (2005) (modifying 11 U.S.C. § 523(a)).

49 11 U.S.C. § 523(a). Under IRC § 6020(a), the IRS may prepare a late return if a taxpayer cooperates by providing "consent to disclose all information necessary for the preparation thereof" and then signs it. When taxpayers do not provide such consent or signatures, the Secretary may prepare a late return or assessment under IRC § 6020(b) "from his own knowledge and from such information as he can obtain through testimony or otherwise."

50 *Beard v. Comm'r*, 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986) (applying a test set forth in *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934)).

51 11 U.S.C. § 523(a)(1)(B)(i).

52 11 U.S.C. § 523(a) (hanging paragraph).

53 The IRS agreed with the taxpayer on this point. *In re Mallo*, 774 F.3d at 1325 (citing Chief Counsel Notice (CCN) CC-2010-016 (Sept. 2, 2010)).

two years before bankruptcy suggests that late returns should not always be excluded simply because they fail to meet the filing requirements.[54]

The court concluded that the exclusion for liabilities with respect to late IRC § 6020(b) returns was not superfluous because late returns could be discharged if they were filed under IRC § 6020(a). The taxpayer argued that allowing those offered IRS assistance in filing late returns under IRC § 6020(a) to discharge the debt, but not allowing a discharge to similarly situated taxpayers who did not receive IRS assistance in filing late would be arbitrary and inconsistent with the fresh start policy underlying bankruptcy. However, the court reasoned that any such arbitrariness would not provide a basis for it to overlook the plain language of the statute.

This case is significant because taxpayers who are even one day late in filing a return will generally not be able to discharge the liability in bankruptcy unless they can convince the IRS to assist them in filing a return under IRC § 6020(a) and it does so at least two years before the bankruptcy filing. Although IRC § 6020(a) filings may have been more common when BAPCPA was adopted,[55] by 2010 they comprised only a "minute number of cases," according to the IRS Office of Chief Counsel.[56] As this may make the availability of discharge arbitrary, the National Taxpayer Advocate recommended legislation to reverse this rule.[57]

In *Hawkins v. Franchise Tax Board of CA,* the United States Court of Appeals for the 9th Circuit held that a debtor's continued spending in excess of earnings is not by itself sufficient to establish the specific willful intent to evade taxes necessary to avoid their discharge in bankruptcy.[58]

Mr. Hawkins's accountants advised him to invest in tax shelters to offset capital gains he had realized on stock he sold to fund a new venture. That venture ultimately failed. In 2002, the IRS disallowed the losses from the tax shelter, and in 2005, assessed a deficiency. Mr. Hawkins and his wife filed for bankruptcy in 2006.

A debtor may not discharge a debt with respect to which he or she "willfully attempted in any manner to evade or defeat," under 11 U.S.C. § 523(a)(1)(C). The IRS argued that the Hawkins' continued maintenance of a rich lifestyle — spending tens of thousands of dollars more than their income each month — even after learning about their tax debts, constituted a willful attempt to evade taxes. The bankruptcy court agreed, finding they did very little to alter their lavish lifestyle after it became apparent they were insolvent. It concluded that the tax debts were nondischargeable. The district court affirmed.

The United States Court of Appeals for the 9th Circuit reversed and remanded, holding that the discharge exception in 11 U.S.C. § 523(a)(1)(C) did not apply without proof of specific intent. First, the court noted that the term "willful" has different meanings in different contexts. Based on statutory

54 11 U.S.C. § 523(a)(1)(B)(ii).

55 Although *Beard* was decided in 1984, when BAPCPA legislation was enacted in 2005 some authorities suggested that Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment*, and Form 4549, *Income Tax Examination Changes*, would be treated as IRC § 6020(a) returns, even if signed in response to an IRS substitute for return. *See, e.g.*, Rev. Rul. 74-203, 1974-1 C.B. 330 (treating these forms as IRC § 6020(a) returns). It was not until September 12, 2005, that the IRS in Rev. Rul. 2005-59, 2005-37 I.R.B. 505, revoked Rev. Rul. 74-203 and clarified that waivers of assessment do not constitute returns because they do not purport to be returns and are not signed under penalties of perjury, as required under the *Beard* test.

56 CCN CC-2010-016 (Sept. 2, 2010).

57 *See* National Taxpayer Advocate 2014 Annual Report to Congress 417-22 (Legislative Recommendation: *Clarify the Bankruptcy Law Relating to Obtaining a Discharge*).

58 *Hawkins v. Franchise Tax Board of CA*, 769 F.3d 662 (9th Cir. 2014), *rev'g and remanding*, 447 B.R. 291 (N.D. CA 2011), *aff'g* 430 B.R. 225 (Bankr. N.D. CA 2010).

construction, precedent, and policy underlying the bankruptcy code, the term must be construed narrowly in the context of exceptions to discharge.

Next, the court reasoned that the language in 11 U.S.C. § 523(a)(1)(C) almost exactly matches language in IRC § 7201, a criminal statute, which penalizes anyone who "willfully attempts to evade or defeat any tax." According to the Supreme Court, the term "willfully" in IRC § 7201 requires proof of specific intent that the defendant voluntarily and intentionally violated a known legal duty.[59]

The 9th Circuit suggested that evidence of willful intent might include keeping two sets of books, making false bookkeeping entries, destroying records, and concealing assets. Simply spending beyond one's income would not qualify. The court observed that if such spending were enough, there would be few personal bankruptcies in which taxes would be dischargeable.

Finally, the court noted that other cases applying the exception from discharge under 11 U.S.C. § 523(a)(1)(C) involved intentional acts or omissions designed to evade tax, such as criminally structuring transactions to avoid currency reporting requirements, concealing assets through nominee accounts, and similar activities. In contrast, the Hawkins' spending practices after they learned of their tax debts were consistent with their historic spending practices. They invested in property that would be subject to tax liens. They did not transfer assets into nominee accounts or conceal them.[60] Further, the court observed that no other circuit has held that living beyond one's means or failing to pay taxes, by itself, constitutes willful tax evasion within the meaning of 11 U.S.C. § 523(a)(1)(C).

This case is significant because it can be construed as creating a circuit split over the conduct that will render tax debts nondischargeable in bankruptcy (*e.g.*, whether evidence of evasion and concealment is required). The case is also significant because it highlights the need for guidance concerning the meaning of willfulness in different contexts.[61]

In *Estate of Elkins v. Commissioner*, the United States Court of Appeals for the 5th Circuit held that if a taxpayer meets its burden to establish that a valuation discount applies, the court cannot apply a different discount if the IRS does not offer evidence of a more appropriate discount.[62]

When James A. Elkins, Jr. (decedent) died in 2006, his estate claimed a "fractional-ownership discount" on the value of jointly-owned art for purposes of computing the estate tax. The art was subject to a lease agreement governing its use and transferability. On the estate tax return, the estate reported decedent's 73 percent interest in various pieces of art, and based on an appraisal, claimed a 44.75 percent combined fractional interest discount for lack of control and marketability.[63] Although the parties agreed on the undiscounted value of the art, the IRS argued in the Tax Court that the contractual restrictions on alienation should be disregarded under IRC § 2703(a), the discounts used in calculating the fair market value of the

59 *Hawkins*, 769 F.3d at 668 (citing *Spies v. U.S.*, 317 U.S. 492 (1943) and other Supreme Court decisions).

60 The government claimed that a transfer of funds into a trust, which was ordered by the family court, was done with the intent to evade tax. Additionally, Hawkins' bankruptcy attorney testified that Hawkins' intent was not to pay the tax debt, but to discharge it in bankruptcy. This evidence may become more important on remand.

61 The National Taxpayer Advocate recommended legislation to clarify the meaning of willful Foreign Bank and Financial Account Reporting (FBAR) violations. *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 331, 339-40.

62 *Est. of Elkins v. Comm'r*, 767 F.3d 443 (5th Cir. 2014), *rev'g* 140 T.C. 86 (2013).

63 *Id.* at 445-46.

decedent's fractional interests were overstated, and no discount was appropriate.[64] Thus, the IRS did not produce any evidence as to an appropriate fractional interest discount.

The Tax Court found that IRC § 2703(a) was applicable to the restrictions in the agreement, and disallowed any discount in the valuation of the art. However, as to the IRS's argument that no discounts should apply to decedent's fractional interest, the court rejected both the IRS's zero-discount position and the 44.75 percent discount applied by the estate.[65] Instead, the Tax Court applied a ten percent discount based on a "preponderance of the evidence," seemingly weighing the analysis of the estate's experts against the IRS's rebuttal witnesses.[66] However, the court had concluded that the testimony of one of the IRS's witnesses was not relevant, and the other merely testified that there was no established or recognized market for fractional interests in the type of art at issue.[67]

The United States Court of Appeals for the 5th Circuit agreed with the Tax Court's conclusion that a fractional-interest discount should apply.[68] It noted that the IRS had apparently overlooked "the venerable lesson of Judge Learned Hand's opinion in *Cohan*: In essence, make as close an approximation as you can, but never use a zero."[69] It concluded; however, that the Tax Court had misapplied the preponderance standard because the IRS had offered no evidence that any specific discount (other than zero) should apply.[70] The Tax Court could not reject the estate's fractional-ownership discounts and apply one of its own without any supporting evidence. Once the estate had met its burden to support a particular discount, the burden shifted to the IRS to introduce evidence to refute those facts with its own estimate.[71] Thus, the 5th Circuit upheld the fractional interest discount applied by the estate.[72]

The 5th Circuit's analysis is significant because it discourages courts (and possibly the IRS's appeals function) from applying a split-the-baby approach to valuation discounts where the IRS presents no evidence as to an appropriate discount. It is also significant because it could prompt the IRS to issue guidance about how to compute valuation discounts.

In *Volpicelli v. United States*, the United States Court of Appeals for the 9th Circuit held that the limitations period for challenging a wrongful levy was subject to equitable tolling.[73]

The IRS levied Logan Volpicelli's account when he was ten years old and applied the money (a $13,000 inheritance) to his father's tax debt. When Mr. Volpicelli was 18, he discovered the levy and promptly filed a wrongful levy suit.[74] The government argued his suit was time barred. Acknowledging that he

64 *Est. of Elkins*, 140 T.C. at 92. *See* IRC § 2703(a) (subject to exceptions for certain bona fide business arrangements, "the value of any property shall be determined without regard to — (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or (2) any restriction on the right to sell or use such property.").

65 *Id.* at 116.

66 *Id.* at 135.

67 *Est. of Elkins*, 767 F.3d at 448-449.

68 *Id.* at 449.

69 *Id.* at 449 n.7 (citing *Cohan v. Comm'r*, 39 F.2d 540, 543-44 (2d Cir. 1930)).

70 *Id.* at 450.

71 *Id*. *See* IRC § 7491(a)(1) ("If, in any court proceeding, a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B, the Secretary shall have the burden of proof with respect to such issue.").

72 *Est. of Elkins*, 767 F.3d at 453.

73 *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015), *rev'g* 108 A.F.T.R.2d (RIA) 5166 (D. Nev. 2011), *reh'g denied*, No. 12-15029 (9th Cir. Apr. 8, 2015).

74 IRC § 7426(a)(1).

failed to meet the nine-month filing deadline under IRC § 6532(c), he argued that the limitations period was equitably tolled because he was a minor at the time of the levy.

The district court agreed with the government, but the United States Court of Appeals for the 9th Circuit reversed and remanded. The court concluded it was bound by precedent, which held that IRC § 6532(c) was subject to equitable tolling.[75] With certain exceptions that the 9th Circuit found inapplicable, there is a rebuttable presumption that filing deadlines may be equitably tolled unless Congress provides otherwise, according to the Supreme Court's decision in *Irwin*.[76] As the court found no evidence to rebut that presumption, it held that equitable tolling applies to the deadline provided under IRC § 6532(c).

This case is significant because it is inconsistent with decisions in other circuits, presenting the potential for the Supreme Court to resolve the split.[77] It may also be significant to the extent it suggests that tax statutes, like other statutes of limitation, are generally presumed to be subject to equitable tolling.[78]

In *Ridgely v. Lew*, the United States District Court for the District of Columbia held that the IRS exceeded its statutory authority when it prohibited certified public accountants from charging contingent fees for the preparation of refund claims.[79]

Mr. Ridgely, a certified public accountant (CPA), filed suit under the Administrative Procedure Act (APA),[80] challenging a Treasury regulation that prohibits CPAs from charging contingent fees for preparing and filing refund claims.[81] The parties moved for summary judgment. Concluding that the IRS lacks statutory authority to regulate the preparation and filing of ordinary refund claims (*i.e.*, claims filed before adversarial proceedings have begun and before the taxpayer has formally engaged the CPA to represent him), the court granted Mr. Ridgely's motion and issued a permanent injunction barring the IRS from enforcing the regulation.

Congress has authorized the IRS to "regulate the practice of representatives of persons before the Department of the Treasury."[82] In *Loving v. IRS,* the U.S. Court of Appeals for the District of Columbia Circuit held that this statute did not authorize the IRS to regulate tax return preparers because they do not "practice… before the Department" or "represent" taxpayers when preparing a return.[83] Citing *Loving*, the U.S. District Court for the District of Columbia found that CPAs also do not "practice… before the Department" or "represent" taxpayers, prior to adversarial proceedings. Accordingly, the statute does not authorize the IRS to regulate the mere filing of ordinary refund claims by CPAs.

75 *Supermail Cargo, Inc. v. U.S.*, 68 F.3d 1204, 1206–07 (9th Cir. 1995); *Capital Tracing, Inc. v. U.S.*, 63 F.3d 859, 861–62 (9th Cir. 1995).

76 *Irwin v. Department of Veterans Affairs*, 498 U.S. 89 (1990).

77 *See, e.g.*, *Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000).

78 For example, at least one commentator has speculated that future litigation could establish that the time periods under IRC § 7433 (giving taxpayers two years to file a suit for civil damages for certain unauthorized collection actions) and § 6532(a) (giving taxpayers two years from the claim disallowance to file a refund lawsuit) are also subject to equitable tolling. *See* Marie Sapirie, *Ninth Circuit Holds Firm on Equitable Tolling*, 2015 TNT 22-9 (Feb. 2, 2015).

79 *Ridgely v. Lew*, 114 A.F.T.R.2d (RIA) 5249 (D.D.C. 2014).

80 5 U.S.C. § 551 *et seq*.

81 31 C.F.R. §§ 10.27(a)-(b) (prohibiting contingent fees except in limited circumstances). This regulation is part of Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service* (2014) (called Circular 230).

82 31 U.S.C § 330(a)(1).

83 *Loving v. Comm'r*, 742 F.3d 1013 (D.C. Cir. 2014), *aff'g* 917 F.Supp.2d 67 (D.D.C. 2013). For a detailed discussion of *Loving*, see National Taxpayer Advocate 2014 Annual Report to Congress 432. *See also* Nina E. Olson, *More Than a "Mere" Preparer: Loving and Return Preparation*, 139 Tax Notes 767 (May 13, 2013).

The court also rejected the IRS's argument that it had authority to regulate all actions of CPAs who at some point "practice" before it, regardless of whether they were acting in a "representational" capacity. First, the statute authorizes regulation of practice, not practitioners. Second, the statute only applies to individuals when they represent taxpayers, not to the actions of every person who may at some point become a representative. Finally, it would lead to absurd results if the IRS could broadly regulate the actions of CPAs, no matter what they were doing, but not regulate other individuals who could assist taxpayers in filing refund claims. The court found no support for this dichotomy in the statute's text, history or structural context.

This case is significant to the extent it suggests that none of the provisions of Circular 230 are valid as to those who merely assist in filing a return or claim for refund (even if they are CPAs or attorneys), at least before the commencement of any adversarial proceedings with the IRS or formal engagement for legal representation. The proliferation of litigation regarding the IRS's regulation of tax return preparers is an indication that Congress should clarify the IRS's authority in this area, as the National Taxpayer Advocate has recommended.[84]

In *Sexton v. Hawkins*, the United States District Court for the District of Nevada enjoined the IRS Office of Professional Responsibility from requesting information from a suspended practitioner or revoking his ability to e-file on behalf of clients.[85]

Mr. Sexton, a tax lawyer, pled guilty to mail fraud and money laundering. As a result, the IRS Office of Professional Responsibility (OPR) suspended him from practice before the IRS for an indefinite period. During his suspension, he provided tax advice and return preparation services. After receiving a demand for information from OPR, including a request for client records and returns, he filed a complaint seeking declaratory relief that he was not subject to OPR's jurisdiction and asked the court to enjoin OPR's request.

According to *Loving*, a person who does not actively represent taxpayers in proceedings with the IRS and only prepares returns is *not* engaged in "practice before the IRS" and is not subject to regulation by OPR under Circular 230.[86] Mr. Sexton argued that because OPR had already suspended him from practice, he was no longer a practitioner covered by Circular 230 and his status as a mere tax return preparer left OPR with no jurisdiction over him. The Justice Department moved to dismiss for lack of jurisdiction and failure to state a claim. The court denied the government's motion and issued a preliminary injunction.

First, the court held that it had jurisdiction to review OPR's information request under the APA because OPR's request for information constituted a "final agency action" that would not otherwise be subject to review.[87] According to the court, OPR's assertion of jurisdiction over Mr. Sexton had immediate consequences, such as his obligation under Circular 230 to respond to its inquiry and the possibility of additional sanctions. If he provided the requested information to OPR, he would have to inform clients that he had turned over their confidential records and doing so would irreparably damage his reputation and business. According to Mr. Sexton, OPR had also threatened to withdraw his ability to e-file returns on behalf of clients if he failed to respond.

84 The National Taxpayer Advocate has long championed the regulation of return preparers. *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 423 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*); National Taxpayer Advocate 2004 Annual Report to Congress 67 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270 (Legislative Recommendation: *Federal Tax Return Preparers Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

85 *Sexton v. Hawkins*, 114 A.F.T.R.2d (RIA) 6482 (D. Nev. 2014), *appeal docketed*, No. 14-17454 (9th Cir. Dec. 16, 2014).

86 *Loving v. Comm'r*, 742 F.3d 1013 (D.C. Cir. 2014), *aff'g* 917 F. Supp. 2d 67 (D.D.C. 2013).

87 5 U.S.C. § 702.

Second, the court found that Mr. Sexton had adequately pleaded facts to raise questions concerning (1) whether Mr. Sexton is a practitioner subject to OPR's jurisdiction, (2) whether OPR had authority to regulate a former practitioner, and (3) whether regulation of tax advice is beyond the scope of OPR's authority. The court entered a preliminary injunction barring the IRS from requesting documents from Mr. Sexton or suspending his ability to e-file. It reasoned that once Mr. Sexton produced the information it could not be "unproduced," and would cause irreparable injury to him and his business. By contrast, waiting would not be a hardship for the IRS or the public interest. The court explained that even if a permanent injunction were granted, the government could continue its investigation by issuing a subpoena.

This case is significant because it illustrates the difficulty OPR now faces in regulating previously-suspended practitioners and the need for Congress to authorize IRS regulation of tax return preparers.[88] It is also significant because it suggests an administrative request for information can be a final agency action, which is subject to judicial review under the APA.

In *Moore v. United States*, the District Court for the Western District of Washington held that the taxpayer did not have reasonable cause for not filing Foreign Bank and Financial Account Reports (FBARs), but found IRS procedures inconsistent with the Administrative Procedure Act (APA).[89]

Mr. Moore owned a foreign corporation that held a foreign bank account containing between $300,000 and $550,000, which he failed to report on Foreign Bank and Financial Account Reports (FBARs).[90] In 2009, he learned about the FBAR filing requirement, applied to the IRS's Offshore Voluntary Disclosure Program (OVD), and then opted out.[91] After interviewing Mr. Moore for five minutes, the Revenue Agent prepared an eight-page memo recommending that the IRS impose a non-willful penalty of $40,000 pursuant to 31 U.S.C. § 5321(a)(5) (the maximum of $10,000 for each of the four years from 2005 through 2008), but did not provide this memo to Mr. Moore.

The IRS sent Mr. Moore a brief letter proposing a penalty of $40,000 for years 2005 through 2008, and then assessed a $10,000 penalty for 2005 before his deadline to appeal had expired. When Mr. Moore appealed, his request for abatement was denied, also without explanation. Mr. Moore filed suit in the District Court for the Western District of Washington. The government counterclaimed and filed a motion for summary judgment.

Applying a *de novo* standard of review, the court held that Mr. Moore's failure to file FBARs was subject to non-willful penalties and was not due to reasonable cause. It declined to review the amount of the penalty under an "abuse of discretion" standard, as urged by the government.

Because "reasonable cause" is not defined in the Bank Secrecy Act (BSA) or in regulations interpreting the BSA, the court drew upon the IRC to define reasonable cause as the exercise of "ordinary business care and prudence" in the context of FBAR. It found Mr. Moore lacked ordinary business care and prudence because he (1) self-prepared his 2005 return without responding to the question on Schedule B about

88 The IRS has conceded that some suspended practitioners may obtain preparer tax identification numbers (PTINs) and prepare returns. *See* IRS, *Some Suspended or Disbarred Tax Practitioners Are Now Permitted to Obtain PTINs and Prepare Tax Returns* (May 23, 2014), *available at* http://www.irs.gov/file_source/pub/irs-utl/OPR%20statement%20052314.pdf. *See also* Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (citing *Loving* and acknowledging the registered tax return preparer program is no longer in effect).

89 *Moore v. U.S.*, 115 A.F.T.R.2d (RIA) 1375 (W.D. Wash. 2015), *dismissed by* 2015 U.S. Dist. LEXIS 99804 (W.D. Wash. 2015).

90 *See* FinCEN Report 114, *Report of Foreign Bank and Financial Accounts* (which superseded TD F 90-22.1).

91 For a discussion of problems with the OVD and recommendations to improve it and the FBAR rules, see, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 79-93, 331-45.

whether he had foreign accounts[92] and (2) responded "no" to a similar question on an organizer he provided to his preparer for his 2007 return. Citing *Williams*, a case that relied on similar facts to hold that an FBAR violation was *willful*, the court concluded that Mr. Moore did not have reasonable cause.[93]

The APA generally requires that an agency's denial of an appeal be accompanied by the "grounds for denial."[94] The court concluded that the government did not sufficiently explain why it denied Mr. Moore's appeal, imposed the maximum penalty for each of the four years, and assessed the 2005 penalty before the agreed date. The court noted that the available evidence, such as the Revenue Agent's internal memo, also failed to explain the IRS's reasons for imposing the maximum penalty.[95] Nor did it explain why the IRS assessed the 2005 penalty before expiration of the period allowed for Mr. Moore's appeal. The court stated that if the government did not supplement the record to explain itself on these issues, it would hold that the IRS's actions were arbitrary and capricious. After the IRS supplemented the record, the court denied the IRS's claim for interest because of its failure to disclose its reasoning but concluded that its actions to assess the penalty were not arbitrary.[96]

Finally, the court concluded the penalty did not violate the *Excessive Fines Clause of the Eighth Amendment*.[97] In *Bajakajian*, the Supreme Court held that a punitive forfeiture of $357,144 in currency (or 100 percent of it) for failure to report it violated the *Excessive Fines Clause* because the penalty was "grossly disproportional" to the gravity of the offense.[98] Although the government provided no evidence as to the harm caused by the offense, the court concluded the $40,000 penalty, which was only about 10 percent of the account balance, was not disproportionate. The court analyzed the proportionality of the FBAR penalties in aggregate, rather than separately for each year or violation.

This case is significant because it suggests that the FBAR penalty (including reasonable cause defenses) is subject to *de novo* review, though the IRS will seek greater judicial deference to its determination of the penalty amount.[99] It also illustrates that a court may rely on the APA in reviewing FBAR penalties and may require the IRS to document and disclose to taxpayers more detailed information concerning the basis for its decisions. Moreover, the court's analysis suggests that it is appropriate to compare the *aggregate* amount of FBAR penalties to the value of the unreported account in determining whether they violate the *Excessive Fines Clause*. Finally, the decision confirms the difficulty taxpayers face in claiming reasonable cause for failure to report an account on an FBAR, if they have not disclosed it to a preparer and have no

92 Mr. Moore admitted he saw the question but did not read the instructions regarding accounts owned by a corporation. Based on those instructions, he should have responded "yes" if he owned more than 50 percent of the stock of a corporation that owned any such accounts.

93 *Williams v. Comm'r*, 489 Fed. App'x. 655 (4th Cir. 2012) (*Williams II*); *Moore v. U.S.*, 115 A.F.T.R.2d (RIA) 1375 (W.D. Wash. 2015) (internal citations omitted) ("the only evidence materially distinguishing the defendant in *Williams II* from Mr. Moore is that defendant pleaded guilty to criminal tax evasion for failing to report the income from the foreign account he had not disclosed.").

94 5 U.S.C. § 555(e).

95 The court did not consider an Appeals memo that was in the IRS's files because the IRS successfully claimed it was privileged.

96 *Moore v. U.S.*, 2015 U.S. Dist. LEXIS 99804 (W.D. Wash. 2015).

97 After applying a balancing test, the court also concluded that the IRS's procedures did not violate the *Due Process Clause*. This analysis confirms that the IRS's procedures must comply with mainstream due process jurisprudence. For commentary on this issue, see Leslie Book, *Procedural Due Process and FBAR*, Procedurally Taxing (May 4, 2015), *available at* http://www.proceduralltaxing.com/procedural-due-process-and-fbar/.

98 *U.S. v. Bajakajian*, 524 U.S. 321 (1998).

99 For further commentary about the significance of this case, see, *e.g.*, Leslie Book, *District Court FBAR Penalty Opinion Raises Important Administrative and Constitutional Law Issues*, Procedurally Taxing (Apr. 6, 2015), *available at* http://www.proceduralltaxing.com/district-court-fbar-penalty-opinion-raises-important-administrative-and-constitutional-law-issues/; Andrew Velarde, *Moore Answers Novel FBAR Questions*, 2015 TNT 71-1 (Apr. 14, 2015).

good explanation for why the question about foreign accounts on Schedule B did not prompt them to read the instructions on the form.

In *Dynamo Holdings Limited Partnership v. Commissioner*, the Tax Court, for the first time, allowed a taxpayer to use predictive coding to limit "e-discovery" to relevant documents.[100]

In consolidated Tax Court proceedings, the IRS moved to compel production of electronically stored information (ESI) on two backup tapes.[101] The taxpayers argued that the IRS's request was excessively burdensome because to avoid producing irrelevant, confidential, and privileged material they would have to review between 3.5 and 7 million documents manually at a cost of $450,000 or more. The taxpayers asked the court to allow them to use predictive coding to limit their response. Predictive coding is a document review tool that uses computer algorithms that learn from a small number of human reviews to predict which documents are likely to be the most relevant. The taxpayers' expert testified that predictive coding could limit the manual document review to 200,000-400,000 documents at a cost of $80,000–$85,000.

The IRS opposed the use of predictive coding, arguing that it is an unproven technology. It also asserted the taxpayers could avoid the cost and expense of reviewing the documents by providing the IRS with access to all data on the tapes, while reserving the right (through a "clawback agreement") to later claim that some or all of the data that the IRS actually tries to introduce is privileged.

Although the court granted the IRS motion to compel production, it found the IRS's proposal of a clawback agreement unreasonable. The court remarked that it is not normally in the position of deciding or imposing a particular *method* of discovery upon the parties, but would make a ruling on the matter as an issue of first impression. Tax Court rules regarding discovery had not yet addressed the issue.[102]

The court relied upon the expert testimony and an article by Magistrate Judge Andrew Peck reviewing the technology.[103] It reasoned that studies have indicated predictive coding is more accurate than keyword searches or even a traditional manual review, as it can reduce human error. The court rejected the IRS's argument that predictive coding is an unproven technology, cited several federal cases that had allowed its use, and granted the taxpayers' request to use it in responding to the IRS request.[104] It concluded that an electronic discovery expert could design an effective search. Finally, the court noted that if the taxpayers did not address all of the IRS's concerns about incomplete discovery, the IRS could file another motion to compel.

This case is significant because it establishes that the Tax Court will allow the use of predictive coding in response to electronic discovery requests. Predictive coding can lessen the significant burden of responding to costly discovery requests by the IRS.

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100 *Dynamo Holdings Ltd. Partnership v. Comm'r*, 143 T.C. No. 9 (2014).

101 The IRS did not want paper copies because it wanted to review the metadata to determine when the ESI was created.

102 *See generally* Tax Court Rule 70(a). However, the court could have relied upon Tax Court Rule 103(a), issuing an order to protect a party from undue burden or expense from a discovery request. Guidance on e-discovery, which the IRS issued in 2012, did not incorporate predictive coding. CCN CC-2012-017 (Sept. 13, 2012).

103 Andrew Peck, Search, *Forward: Will Manual Document Review and Keyboard Searches Be Replaced by Computer-Assisted Coding?*, L. Tech. News (Oct. 2011).

104 *See, e.g.*, *Hinterberger v. Catholic Health Sys., Inc.*, 2013 WL 2250603 (W.D.N.Y. 2013); *Moore v. Publicis Groupe*, 287 F.R.D. 182 (S.D.N.Y 2012); *In Re Actos*, 2012 WL 7861249 (W.D. La. 2012).

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

SUMMARY

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

TAXPAYER RIGHTS IMPACTED[2]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

PRESENT LAW

The amount of an accuracy-related penalty equals 20 percent of the portion of the underpayment attributable to the taxpayer's negligence or disregard of rules or regulations, or to a substantial understatement.[3] Underpayment is the amount by which any tax imposed by the IRC exceeds the excess of:

> The sum of (A) the amount shown as the tax by the taxpayer on his return, plus (B) amounts not shown on the return but previously assessed (or collected without assessment), over the amount of rebates made.[4]

Prior to December 18, 2015, refundable credits could not reduce below zero the amount shown as tax by the taxpayer on a return.[5] However, recently enacted law reversed the Tax Court's decision in *Rand v. Commissioner*, and amended IRC § 6664(a) to be consistent with the rule of IRC § 6211(b)(4), which would allow the IRS to calculate negative tax in computing the amount of underpayment for

1 IRC § 6662(b)(3) authorizes a penalty for any substantial valuation misstatement under chapter 1 [IRC §§ 1-1400U-3]; IRC § 6662(b)(4) authorizes a penalty for any substantial overstatement of pension liabilities; IRC § 6662(b)(5) authorizes a penalty for any substantial valuation understatement of estate or gift taxes; IRC § 6662(b)(6) authorizes a penalty when the IRS disallows the tax benefits claimed by the taxpayer when the transaction lacks economic substance; and IRC § 6662(b)(7) authorizes a penalty for any undisclosed foreign financial asset understatement. We have chosen not to cover them in this report, as those penalties were not litigated nearly as much as IRC §§ 6662(b)(1) and 6662(b)(2) during the period we reviewed.

2 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

3 IRC § 6662(b)(1) (negligence/disregard of rules or regulations); IRC § 6662(b)(2) (substantial understatement of income tax).

4 IRC § 6664(a).

5 *Rand v. Comm'r*, 141 T.C. 376 (2013). *See also* National Taxpayer Advocate 2014 Annual Report to Congress 449; IRS, Chief Counsel Notice CC-2014-007, *Application of the Accuracy-Related or Fraud Penalty in Tax Court Cases Involving Disallowed Refundable Credits* (July 31, 2014) (litigation guidelines for cases impacted by the *Rand* decision). The Chief Counsel Notice is deemed to be "effective until further notice," perhaps implying that this is not the last word on the issue from the IRS's perspective. Following *Rand*, there has been a legislative proposal to calculate negative tax in computing the amount of underpayment for accuracy-related penalty purposes. *See* H.R. 1, § 6306, 113th Cong. 2d Sess. (2014). *See also* Joint Committee on Taxation, *Technical Explanation of the Tax Reform Act of 2014, A Discussion Draft of the Chairman of the House Committee on Ways and Means to Reform the Internal Revenue Code: Title VI- Tax Administration and Compliance* (JCX-17-14) (Feb. 26, 2014), at 41-43.

accuracy-related penalty purposes.[6] Thus, for returns filed after December 18, 2015, or for returns filed before that date for which the period of limitations on assessment under IRC § 6501 has not expired, a taxpayer can be subject to an underpayment penalty in IRC § 6662 based on a refundable credit which reduces tax below zero.

The IRS may assess penalties under IRC §§ 6662(b)(1) and 6662(b)(2), but the total penalty rate generally cannot exceed 20 percent (*i.e.*, the penalties are not "stackable").[7] Generally, taxpayers are not subject to the accuracy-related penalty if they establish that they had reasonable cause for the underpayment and acted in good faith.[8] In addition, a taxpayer will be subject to the negligence component of the penalty only on the portion of the underpayment attributable to negligence. If a taxpayer wrongly reports multiple sources of income, for example, some errors may be justifiable mistakes, while others might be the result of negligence; the penalty applies only to the latter.

Negligence

The IRS may impose the IRC § 6662(b)(1) negligence penalty if it concludes that a taxpayer's negligence or disregard of the rules or regulations caused the underpayment. Negligence is defined to include "any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard."[9] Negligence includes a failure to keep adequate books and records or to substantiate items that give rise to the underpayment.[10] Strong indicators of negligence include instances where a taxpayer failed to report income on a tax return that a payor reported on an information return[11] as defined in IRC § 6724(d)(1),[12] or failed to make a reasonable attempt to ascertain the correctness of a deduction, credit, or exclusion.[13] The IRS can also consider various other factors in determining whether the taxpayer's actions were negligent.[14]

Substantial Understatement

Generally, an "understatement" is the difference between (1) the correct amount of tax and (2) the tax reported on the return, reduced by any rebate.[15] Understatements are reduced by the portion attributable to (1) an item for which the taxpayer had substantial authority or (2) any item for which the taxpayer, in the return or an attached statement, adequately disclosed the relevant facts affecting the item's tax treatment and the taxpayer had a reasonable basis for the tax treatment.[16] For individuals, the understatement

6 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 209 (2015).

7 Treas. Reg. § 1.6662-2(c). The penalty rises to 40 percent if any portion of the underpayment is due to a "gross valuation misstatement." IRC § 6662(h)(1); Treas. Reg. § 1.6662-2(c).

8 IRC § 6664(c)(1).

9 IRC § 6662(c).

10 Treas. Reg. § 1.6662-3(b)(1).

11 Treas. Reg. § 1.6662-3(b)(1)(i).

12 IRC § 6724(d)(1) defines an information return by cross-referencing various other sections of the IRC that require information returns (*e.g.*, IRC § 6724(d)(1)(A)(ii) cross-references IRC § 6042(a)(1) for reporting of dividend payments).

13 Treas. Reg. § 1.6662-3(b)(1)(ii).

14 These factors include the taxpayer's history of noncompliance; the taxpayer's failure to maintain adequate books and records; actions taken by the taxpayer to ensure the tax was correct; and whether the taxpayer had an adequate explanation for underreported income. Internal Revenue Manual (IRM) 4.10.6.2.1, *Negligence* (May 14, 1999). *See also* IRM 20.1.5.2(6), *Common Features of Accuracy-Related and Civil Fraud Penalties* (Jan. 24, 2012).

15 IRC §§ 6662(d)(2)(A)(i)-(ii).

16 IRC §§ 6662(d)(2)(B)(i)-(ii). No reduction is permitted, however, for any item attributable to a tax shelter. *See* IRC § 6662(d)(2)(C)(i). If a return position is reasonably based on one or more of the authorities set forth in Treas. Reg. § 1.6662-4(d)(3)(iii), the return position will generally satisfy the reasonable basis standard. This may be true even if the return position does not satisfy the substantial authority standard found in Treas. Reg. § 1.6662-4(d)(2). *See* Treas. Reg. § 1.6662-3(b)(3).

of tax is substantial if it exceeds the greater of $5,000 or ten percent of the tax that must be shown on the return.[17] For corporations (other than S corporations or personal holding companies), an understatement is substantial if it exceeds the lesser of ten percent of the tax required to be shown on the return (or if greater, $10,000), or $10,000,000.[18]

For example, if the correct amount of tax is $10,000 and an individual taxpayer reported $6,000, the substantial underpayment penalty under IRC § 6662(b)(2) would not apply because although the $4,000 shortfall is more than ten percent of the correct tax, it is less than the fixed $5,000 threshold. Conversely, if the same individual reported a tax of $4,000, the substantial understatement penalty would apply because the $6,000 shortfall is more than $5,000, which is the greater of the two thresholds.

Reasonable Cause

The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.[19] A reasonable cause determination takes into account all of the pertinent facts and circumstances.[20] Generally, the most important factor is the extent to which the taxpayer made an effort to determine the proper tax liability.[21]

Reasonable Basis

An understatement of tax may be reduced by any portion of the understatement attributable to an item for which the tax treatment is adequately disclosed and supported by a reasonable basis.[22] This standard is met if the taxpayer's position reasonably relies on one or more authorities listed in Treas. Reg. § 1.6662-4(d)(3)(iii).[23] Applicable authority could include information such as sections of the IRC; proposed, temporary, or final regulations; revenue rulings and revenue procedures; tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties; court cases; and congressional intent as reflected in committee reports.[24]

17 IRC §§ 6662(d)(1)(A)(i)-(ii).
18 IRC §§ 6662(d)(1)(B)(i)-(ii).
19 IRC § 6664(c)(1).
20 Treas. Reg. § 1.6664-4(b)(1).
21 *Id*.
22 IRC § 6662(d)(2)(B)(ii)(II).
23 Treas. Reg. § 1.6662-3(b)(3).
24 Treas. Reg. § 1.6662-4(d)(3)(iii).

Penalty Assessment and the Litigation Process

In general, the IRS proposes the accuracy-related penalty as part of its examination process[25] and through its Automated Underreporter (AUR) computer system.[26] Theoretically, before a taxpayer receives a notice of deficiency, he or she has an opportunity to engage the IRS on the merits of the penalty.[27] Once the IRS concludes an accuracy-related penalty is warranted, it must follow deficiency procedures (*i.e.*, IRC §§ 6211-6213).[28] Thus, the IRS must send a notice of deficiency with the proposed adjustments and inform the taxpayer that he or she has 90 days to petition the United States Tax Court to challenge the assessment.[29] Alternatively, taxpayers may seek judicial review through refund litigation.[30] Under certain circumstances, a taxpayer can request an administrative review of IRS collection procedures (and the underlying liability) through a Collection Due Process hearing.[31]

Burden of Proof

In court proceedings, the IRS bears the initial burden of production regarding the accuracy-related penalty.[32] The IRS must first present sufficient evidence to establish that the penalty is warranted.[33] The burden of proof then shifts to the taxpayer to establish any exception to the penalty, such as reasonable cause.[34] Because the reasonable basis standard is a higher standard to meet, it is possible that a taxpayer

25 IRM 4.10.6.2(1), *Recognizing Noncompliance* (May 14, 1999) ("assessment of penalties should be considered throughout the audit"). *See also* IRM 20.1.5.3(1)-(2), *Examination Penalty Assertion* (Jan. 24, 2012).

26 The AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payors reported via Form W-2, Form 1099, and other information returns. IRM 4.19.3.1(3)-(8), *Overview of IMF Automated Underreporter* (Sept. 30, 2014). IRC § 6751(b)(1) provides the general rule that IRS employees must have written supervisory approval before assessing any penalty. However, IRC § 6751(b)(2)(B) allows an exception for situations where the IRS can calculate a penalty automatically "through electronic means." The IRS interprets this exception as allowing it to use its AUR system to propose the substantial understatement and negligence components of the accuracy-related penalty without human review. If a taxpayer responds to an AUR-proposed assessment, the IRS first involves its employees at that point to determine whether the penalty is appropriate. If the taxpayer does not respond timely to the notice, the computers automatically convert the proposed penalty to an assessment without managerial review. IRM 4.19.3.20.1.4, *Accuracy-Related Penalties* (Sept. 1, 2012). *See also* National Taxpayer Advocate 2014 Annual Report to Congress 404-10 (Legislative Recommendation: *Managerial Approval: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence Under IRC § 6662(b)(1)*); National Taxpayer Advocate 2007 Annual Report to Congress 259 ("Although automation has allowed the IRS to more efficiently identify and determine when such underreporting occurs, the IRS's over-reliance on automated systems rather than personal contact has led to insufficient levels of customer service for taxpayers subject to AUR. It has also resulted in audit reconsideration and tax abatement rates that are significantly higher than those of all other IRS examination programs.").

27 For example, when the IRS proposes to adjust a taxpayer's liability, including additions to tax such as the accuracy-related penalty, it typically sends a notice ("30-day letter") of proposed adjustments to the taxpayer. A taxpayer has 30 days to contest the proposed adjustments to the IRS Office of Appeals, during which time he or she may raise issues related to the deficiency, including any reasonable cause defense to a proposed penalty. If the issue is not resolved after the 30-day letter, the IRS sends a statutory notice of deficiency ("90-day letter") to the taxpayer. *See* IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree* (Jan. 1999); IRS Pub. 3498, *The Examination Process* (Nov. 2004).

28 IRC § 6665(a)(1).

29 IRC § 6213(a). A taxpayer has 150 days rather than 90 days to petition the Tax Court if the notice of deficiency is addressed to a taxpayer outside the United States.

30 Taxpayers may litigate an accuracy-related penalty by paying the tax liability (including the penalty) in full, filing a timely claim for refund, and then timely instituting a refund suit in the appropriate United States District Court or the Court of Federal Claims. 28 U.S.C. § 1346(a)(1); 28 U.S.C. § 1491; IRC §§ 7422(a); 6532(a)(1); *Flora v. United States*, 362 U.S. 145 (1960) (requiring full payment of tax liabilities as a prerequisite for jurisdiction over refund litigation).

31 IRC §§ 6320 and 6330 provide for due process hearings in which a taxpayer may raise a variety of issues including the underlying liability, provided the taxpayer did not receive a statutory notice of deficiency or did not otherwise have an opportunity to dispute such liability. IRC §§ 6320(c), 6330(c)(2)(B).

32 IRC § 7491(c) provides that "the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title."

33 *Higbee v. Comm'r*, 116 T.C. 438, 446 (2001).

34 IRC § 7491(a). *See also* Tax Ct. R. 142(a).

may obtain relief from a penalty assessment by successfully arguing a reasonable cause defense, even if that defense does not satisfy the reasonable basis standard.[35]

ANALYSIS OF LITIGATED CASES

We identified 113 opinions issued between June 1, 2014, and May 31, 2015 where taxpayers litigated the negligence/disregard of rules or regulations or substantial understatement components of the accuracy-related penalty. The IRS prevailed in full in 87 cases (77 percent), taxpayers prevailed in full in 20 cases (18 percent), and six cases (five percent) resulted in split decisions. Table 1 in Appendix 3 provides a detailed list of these cases.

Taxpayers appeared *pro se* (without representation) in 68 of the 113 cases (60 percent) and convinced the court to dismiss or reduce the penalty in 14 (21 percent) of those cases. Represented taxpayers fared approximately the same, achieving full or partial relief from the penalty in 12 of their 45 cases (27 percent). This difference was considerably smaller than the large disparity between represented and unrepresented taxpayers over the same period last year.[36]

In some cases, the court found taxpayers liable for the accuracy-related penalty but failed to clarify whether it was for negligence under IRC § 6662(b)(1) or a substantial understatement of tax under IRC § 6662(b)(2), or both.[37] Regardless of the subsection at issue, the analysis of reasonable cause is generally the same. As such, we have combined our analyses of reasonable cause for the negligence and substantial understatement cases.

Adequacy of Records and Substantiation of Deductions to Show Reasonable Cause and as Proof of Taxpayer's Good Faith

Taxpayers are required to maintain records sufficient to establish the amount of gross income, deductions, and credits claimed on a return.[38] The failure "to keep adequate books and records or to substantiate items properly" was the primary factor in roughly 74 percent of cases (34 out of 46) where the court found a taxpayer liable for an underpayment penalty due to negligence.[39]

In *Sawyer v. Commissioner*,[40] a married couple owned an asphalt business operated by the husband, Mr. Sawyer. Mr. Sawyer paid his day laborers in cash, without issuing Forms W-2, *Wage and Tax Statement*, or 1099-MISC, *Miscellaneous Income*.[41] Customers also paid Mr. Sawyer by cash or check, and he conceded that he deposited only a portion of the payments into his personal bank account. The only records he kept included invoices from his jobs.

As part of the examination, the revenue agent conducted an analysis of bank deposits and was unable to link the invoices provided with specific bank deposits. As a result, the revenue agent determined the business's gross receipts were underreported in tax years (TYs) 2008 and 2009. The revenue agent also denied

35 Treas. Reg. § 1.6662-3(b)(3).

36 *See* National Taxpayer Advocate 2014 Annual Report to Congress 446 (penalties were reduced in 14 percent of the *pro se* cases versus 32 percent of cases involving represented taxpayers).

37 *See, e.g.*, *Coburn v. Comm'r*, T.C. Memo. 2014-113; *Cooper v. Comm'r*, 143 T.C. 194 (2014).

38 IRC § 6001; Treas. Reg. § 1.6001-1(a).

39 *See, e.g.*, *Burrell v. Comm'r*, T.C. Memo. 2014-217; *Kunkel v. Comm'r*, T.C. Memo. 2015-71; *Briley v. Comm'r*, T.C. Memo. 2014-114.

40 T.C. Memo. 2015-55.

41 Form 1099-MISC, *Miscellaneous Income*, is used to report non-employee compensation.

deductions claimed for labor costs for TY 2008 because the taxpayer failed to establish that costs were paid or incurred in TY 2008 (or accounted for as labor completed by Mr. Sawyer or his family).

The court found the Sawyers liable for a penalty under IRC § 6662(b)(1). The Sawyers had argued a reasonable cause defense based on Mr. Sawyer's reliance on his accountant in preparing the tax return. However, the court found that Mr. Sawyer had not provided his accountant with the necessary information for reasonable reliance, as the invoices and receipts had not been provided and labor costs were merely an estimate.

In the more than 30 cases where the court attributed an underpayment to taxpayer negligence primarily due to record keeping, the court found the taxpayer acted with reasonable cause and in good faith in only one instance.[42] Inadequate record keeping was also an important factor in many determinations of whether the reasonable cause and good faith exception applied to a taxpayer's conduct. Some courts examined the issues of negligent record keeping and reasonable cause concurrently.

For example, in *Engstrom, Lipscomb & Lack, APC v. Commissioner*,[43] the taxpayer, a law firm, claimed travel expense deductions in connection with the use of two private jets. Mr. Lack was 50 percent owner of the law firm (hereinafter Engstrom). Mr. Girardi was a close friend of Mr. Lack. Together they had several joint business ventures, including G&L Aviation, a general partnership that owned aircraft and a luxury suite at the Staples Center in Los Angeles. Mr. Lack and Mr. Girardi used the aircraft extensively. Engstrom was not a partner of G&L Aviation and had no financial interest in the aircraft.

Engstrom claimed travel expense deductions for use of the aircraft and luxury suite in the amounts of $1,425,000; $1,157,797; $687,310; and $1,062,469 for years 2007 through 2010, respectively. Engstrom made payments to G&L Aviation and Mr. Lack also made payments to G&L Aviation from his personal account. There was no written agreement between Engstrom and G&L Aviation, and Engstrom did not receive invoices for payments made. However, Mr. Lack's secretary, Ms. Carter, who was employed by Engstrom, also performed recordkeeping duties for G&L Aviation. She prepared revenue schedules to show dates of payments to G&L Aviation, but these schedules did not include flight information, passenger information, or the purpose of each flight. G&L maintained flight logs, but these logs did not show the business purpose for each flight or provide detailed passenger information. Lastly, Mr. Lack maintained an executive calendar but did not include amounts for travel expenditures or detailed information regarding the business purpose for each trip.

IRC § 162 allows for the deduction of all ordinary and necessary expenses paid or incurred while carrying on a trade or business.[44] Such expenses can include the costs of travel.[45] To substantiate its claim for deductions at trial, Engstrom offered a reconstruction of the trips that included the date, destination, and passengers. This information was reconstructed from logs prepared by Ms. Carter and Mr. Lack.

42 *Lain v. Comm'r*, T.C. Summ. Op. 2015-5 (finding that the taxpayers substantiated only a portion of their claimed deductions, however; also finding that a burst water pipe may have prevented the taxpayers from substantiating all of the deductions).

43 T.C. Memo. 2014-221, *appeal docketed*, No. 15-70591 (9th Cir. Feb. 26, 2015).

44 For a detailed discussion of IRC § 162 and deductibility of expenses, see Most Litigated Issue: *Trade or Business Expenses Under IRC § 162 and Related Sections*, *infra*.

45 IRC § 162(a)(2).

Two pertinent issues at trial included whether Engstrom was entitled to travel expense deductions under IRC § 162 and if Engstrom was liable for an accuracy-related penalty under IRC § 6662. To make its determination, the court divided the flights into three categories:

1. Flights on which Mr. Lack and Engstrom employees were passengers;
2. Flights on which Mr. Lack was the only Engstrom employee; and
3. Flights on which neither Mr. Lack nor any other Engstrom employee was a passenger.

The court found that Engstrom would be entitled to deductions for the first category only when the expense for each flight was properly substantiated. For the second category, the court allowed deductions only when it was readily apparent that the flight had a business purpose for Engstrom. No deductions were allowed for flights in the third category. Within this framework, the court found that many of the flights did not meet the heightened requirements for substantiation under IRC § 274(d).[46]

The court noted that the revenue schedules prepared by Ms. Carter included payment information but lacked flight information, such as a list of passengers or the business purpose for the flight. Mr. Lack's executive calendar did not include amounts of travel expenses or the business purpose for each flight. The flight logs kept by the pilots also failed to note any business purpose for the flights and did not contain passenger information. The court deemed the logs prepared by Ms. Carter and Mr. Lack noncontemporaneous and prepared in anticipation of trial. As a result, the court allowed only a portion of the claimed travel expenses to be deducted.

The court imposed a penalty for negligence under IRC § 6662(b)(1) for failure to keep adequate records. In its analysis of reasonable cause, the court found that the "[p]etitioner failed to establish reasonable cause for not keeping sufficient contemporaneous records showing important flight details and the business purpose of the travel."[47] Thus, reasonable cause was rejected based on the same evidence that established negligence.

Reasonable cause and good faith may be found if there is "an honest misunderstanding of fact or law."[48] For example, in *Dabney v. Commissioner*,[49] Mr. Dabney wanted to increase the value of his individual retirement account (IRA) by investing in real estate with funds from his IRA. He researched this investment option on the Internet and found that IRAs could hold property for investment. He spoke with a customer service representative at Charles Schwab, his investment firm, who informed him that Charles Schwab did not allow the purchase and holding of real estate. Mr. Dabney also contacted his accountant, who agreed with Mr. Dabney's assessment after reviewing his research material.

Mr. Dabney went through with his plan and had $114,000 withdrawn from his IRA. The money was wired directly to a title company in order to purchase real estate for investment purposes. He requested that the title be issued in his name along with the name of his IRA account with Charles Schwab. He later sold the property and had the proceeds of the sale sent directly to his account at Charles Schwab as a

46 To be deductible as a business expense under IRC § 162, travel expenses require sufficient evidence of (1) the amount of the expense; (2) the time and place of the travel; (3) the business purpose of the expense; and (4) the business relationship of the taxpayer to the person using the property. IRC § 274(d). While a contemporaneous record is not required, "a record of the elements of an expenditure or of a business use of listed property made at or near the time of the expenditure or use, supported by sufficient documentary evidence, has a high degree of credibility not present with respect to a statement prepared subsequent thereto when generally there is a lack of accurate recall." Treas. Reg. § 1.274-5T(c)(1).

47 T.C. Memo. 2014-221.

48 Treas. Reg. § 1.6664–4(b)(1).

49 T.C. Memo. 2014-108.

rollover contribution. Charles Schwab issued a Form 1099 to the Dabneys, though Mr. Dabney did not recall receiving it. Mr. Dabney did not report this withdrawal as income on the couple's 2009 tax return. The IRS subsequently determined a deficiency of $42,431 against the couple and imposed an accuracy-related penalty of $8,486.

The court found that, as a matter of policy, the Charles Schwab IRA did not allow real property to be held for investment and therefore the transfer of funds was not between trustees, as required for a rollover contribution. As a result, Mr. Dabney was required to report this withdrawal as income on his tax return. However, the court declined to impose an accuracy-related penalty on the Dabneys. In reaching this determination, the court analyzed Mr. Dabney's good faith attempt at compliance. The court noted that Mr. Dabney was not a sophisticated taxpayer, had no background in tax or accounting, and had gone to great lengths to ensure that using funds from his IRA would be non-taxable. Mr. Dabney's research confirmed that IRAs are permitted to hold real property, he made sure the property was held for investment purposes, he obtained a scrivener's affidavit to fix an issue with the title, and made sure the funds were wired directly. He also conferred with a Charles Schwab customer service representative and his accountant on multiple occasions regarding the transaction. Although Mr. Dabney was mistaken, the court found that he had acted with reasonable cause and in good faith.[50]

Reasonable Basis

In some situations, a taxpayer may not be certain as to how the IRS will respond to the tax treatment employed for a specific set of circumstances. Disclosing the tax treatment used for an issue on the return, supported by a reasonable basis, can reduce the amount of an underpayment for purposes of the accuracy-related penalty.[51] A tax position supported by a reasonable basis will also defeat a negligence claim.[52]

For example, in *Wells Fargo & Co. v. United States*,[53] the taxpayer, a bank, claimed foreign tax credits from income taxes paid to the United Kingdom and expenses attributable to a Structured Trust Advantaged Repackaged Securities (STARS) transaction. Wells Fargo entered into the STARS transaction with Barclays, a bank based in the United Kingdom (U.K.).[54] The transaction was intended to provide tax benefits to both banks from the same income tax payments in the United Kingdom, but the IRS viewed it as a sham transaction and imposed an accuracy-related penalty on negligence grounds.

50 Though this case involved a deficiency on a joint return and liability for the accuracy-related penalty for both Mr. and Mrs. Dabney, the court granted a motion to dismiss Mrs. Dabney for lack of prosecution and held that it would hold her to a liability consistent with the opinion.

51 IRC § 6662(d)(2)(B)(ii).

52 Treas. Reg. § 1.6662-3(b)(1) ("A return position that has a reasonable basis… is not attributable to negligence.").

53 114 A.F.T.R.2d (RIA) 5414 (D. Minn. 2014).

54 In general, a STARS transaction is a multistep transaction that enables a U.S. participant to realize an economic benefit by claiming foreign tax credits. The STARS transaction in *Wells Fargo* consisted of a loan and a trust component. Wells Fargo transferred income-producing assets to a U.K.-based trust. The assets had no relation to the U.K. However, the trust was considered a resident of the U.K., and thus, the income generated by the trust was subject to U.K taxes. The income realized by the U.K. trust and the U.K. income taxes paid by it were treated as received and paid by Wells Fargo. Under U.K. law, almost all of the after-U.K. tax income of the trust was treated as a distribution to Barclays. The after-U.K. tax trust income allocated to Barclays was immediately credited to a blocked account ("Bx") in the name of Barclays that was maintained by Wells Fargo and then reinvested in the trust. Barclays was obligated to pay consideration to Wells Fargo of a fixed amount each month that was calculated to be a percentage of the U.K. tax credits that Barclays expected to enjoy as a result of the allocation of trust income. Barclays also deducted the Bx amounts in the calculation of its U.K. income tax liability. The combination of U.K. tax credits and U.K. deductions (for the amounts allocated to the blocked account and contributed back to the trust and the Bx payments) created a net profit to Barclays under U.K. tax law as a result of its involvement in the STARS transaction. Barclays effectively loaned $1.25 billion to Wells Fargo at an interest rate of 0.2 percent. *See also* Ajay Gupta, *Interest Deductibility in Stars Cases*, Tax Notes Today, Jan. 26, 2015, 2015 TNT 16-4.

The IRS argued that taxpayer participation in a sham transaction is necessarily negligent, requiring that the issue of the transaction's economic substance be determined. The court found there was insufficient support for the IRS's position. It held that the negligence penalty would be avoided if Wells Fargo's position was supported by a reasonable basis, even if the sham transaction issue is eventually lost. The court held that Wells Fargo had established a reasonable basis, supported by (1) the tax code, (2) regulations, (3) tax treaties, and (4) judicial decisions; and granted the taxpayer's motion for partial summary judgment that there was a reasonable basis for the STARS transaction reporting.

Reliance on the Advice of a Tax Professional as Reasonable Cause

Another commonly litigated question was whether reliance on a tax professional established reasonable cause. The taxpayer's education, sophistication, and business experience are relevant in determining whether his reliance on tax advice was reasonable.[55] To prevail, a taxpayer must establish that:

1. The adviser was a competent professional who had sufficient expertise to justify reliance;
2. The taxpayer provided necessary and accurate information to the adviser; and
3. The taxpayer actually relied in good faith on the adviser's judgment.[56]

Taxpayers argued their good faith reliance on a competent tax professional in several cases this year, including *Evans v. Commissioner*.[57] In *Evans*, the married taxpayers ran a construction company, Dave Evans Construction (DEC). The taxpayers sponsored their son's successful motocross racing as a promotional activity for DEC. They deducted these expenses (including the purchase of a motorhome, a Mirage trailer, and a utility trailer) as ordinary and necessary expenses for their company pursuant to IRC § 162. The IRS argued that such expenses were not ordinary and necessary for the business and instead were personal expenses that should not have been deducted.[58]

The court ruled in favor of Mr. and Mrs. Evans. The court found that the expenses were business in nature, as the promotion of motocross led to increased exposure to clients, investors, and subcontractors. In particular, the court noted the local construction industry's significant involvement in motocross racing. Further, only one child's expenses were deducted, other corporate support was acquired for his racing, and their deductions stopped when the son became a professional racer. The court held that the expenses were reasonable in amount, as they totaled less than one percent of gross receipts for DEC. Additionally, the court found that the motorhome was not primarily used for lodging as it had a ramp and was used to store, transport, and repair motorbikes as well. The court did not allow expenses to be deducted in association with the utility trailer, as the taxpayers did not prove it was used for an advertising purpose.

The taxpayers hired Ms. Chacon, a certified public accountant (CPA), who testified that she provided necessary documents to Mr. Anderson, a separate CPA, and answered questions as he prepared the returns. The court held that taxpayers had reasonably relied in good faith on Mr. Anderson's judgment for the disallowed deductions and, therefore, were not subject to a penalty under IRC § 6662.

In *Gardner v. Commissioner*,[59] Mr. Gardner was involved in many businesses, including insurance and home construction. In 2001, he entered into agreements with David Pearl and John Pearl to breed

55 Treas. Reg. § 1.6664-4(c)(1). *See also* IRM 20.1.5.6.1(6), *Reasonable Cause* (Jan. 24, 2012).

56 *Neonatology Associates, P.A. v. Comm'r*, 115 T.C. 43, 99 (2000) (citations omitted), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

57 T.C. Memo. 2014-237. *See also VisionMonitor Software, LLC v. Comm'r.*, T.C. Memo. 2014-182.

58 For information on business expenses deductions, see IRC § 162 and Most Litigated Issue: *Trade or Business Expenses Under IRC § 162 and Related Sections*, *infra*.

59 T.C. Memo. 2014-148.

genetically superior cattle, which would be jointly owned. Mr. Gardner executed 24 promissory notes with entities owned by the Pearls, with the cattle as collateral. The cattle operation amassed $991,842 in expenses over ten years for a net reported loss of $621,677. Although the only evidence of payment was checks totaling $74,618, the taxpayer deducted all of these losses as business expenses under IRC § 162. The court held that the Mr. Gardner was not eligible to claim these deductions because the cattle operation was an activity not engaged in for profit.[60]

Mr. Gardner argued for a reasonable cause and good faith exception based on his reliance on his CPA. His accountant relied solely upon income and expense summaries prepared by David Pearl for the cattle operation. While the court found the CPA to be a competent professional, it found that Mr. Gardner had, in fact, relied upon David Pearl for tax purposes and not the CPA. As David Pearl had no expertise in accounting or taxation, the court found Mr. Gardner failed the first prong of the reasonable reliance test. The court further found that he had failed to provide the necessary and accurate information to his CPA, a requirement under the second prong in *Neonatology Associates, P.A. v. Commissioner*.

Reliance on tax advice from the promoter of a transaction or an advisor with an inherent conflict of interest may also not be reasonable. For example, in *Salem Financial, Inc. v. United States*, Salem Financial, a subsidiary of Branch Banking and Trust (BB&T), sought a tax refund related to a STARS transaction.[61]

In 2002, BB&T entered into the STARS transaction with Barclays Bank, which was located in the United Kingdom (U.K.). Barclays developed the STARS transaction along with KPMG LLP, an international accounting firm. KPMG also recommended that BB&T hire Sidley, Austin, Brown & Wood LLP (Sidley) as its tax advisor on the STARS transaction. BB&T followed this recommendation and also requested that its accounting firm PricewaterhouseCoopers (PwC) review the transaction, but not for tax compliance purposes.

Essentially, BB&T created a trust and contributed $5.755 billion of assets to it. Barclays gave $1.5 billion to the trust in return for an interest in the trust. The terms of this part of the agreement meant the $1.5 billion was a loan from Barclays to BB&T. BB&T appointed a U.K. trustee to the trust, subjecting the trust to taxation in the U.K. BB&T used trust funds to pay the U.K. tax on the trust's income. Barclays then received U.K. tax deductions and credits, and it made a monthly payment to BB&T, which was equal to 51 percent of the U.K. taxes paid by the trust. BB&T then claimed a foreign tax credit. The ability for there to be a profit from this transaction relied on both BB&T and Barclays being able to successfully obtain their respective tax credits.

On March 30, 2007, the IRS issued proposed regulations addressing schemes such as the STARS transaction. BB&T terminated the trust six days later. It filed returns claiming foreign tax credits and interest deductions. Upon review, the IRS denied both claims and imposed accuracy-related penalties. BB&T sued in the Court of Federal Claims for federal tax credits and interest deductions disallowed by the IRS as well as accuracy-related penalties imposed.[62] The Court of Federal Claims denied the claim finding that it was not reasonable for Salem Financial to have relied on KPMG, Sidley, or PwC for tax advice, and BB&T appealed.

60 *See generally* IRC § 183 and the nine-factor test in Treas. Reg. § 1.183-2(b).

61 786 F.3d 932 (Fed. Cir. 2015), *aff'g in part*, *reversing in part and remanding*, 112 Fed. Cl. 543 (2013), *petition for cert. filed*, No. 15-380 (Sept. 29, 2015). See footnote 53, *supra*, for a detailed discussion of the same STARS transaction involving Barclays and Wells Fargo.

62 *Salem Fin., Inc. v. United States*, 112 Fed. Cl. 543 (2013), *rev'd in part and remanded by* 786 F.3d 932 (Fed. Cir. 2015), *petition for cert. filed*, No. 15-380 (Sept. 29, 2015).

On appeal, the Court of Appeals for the Federal Circuit found the STARS transaction to be a sham and disregarded all of its tax consequences. The court also upheld the imposition of accuracy-related penalties against Salem Financial. At trial, Salem Financial asserted that it reasonably relied upon the favorable tax opinion from Sidley and supportive advice from its accounting firm, PwC.

In its decision, the court notes that reliance on an advisor is not reasonable if that advisor has a conflict of interest that the taxpayer is aware of or if the transaction is "too good to be true." The court found reliance on Sidley to be unreasonable because Sidley had been selected by Salem Financial on recommendation of KPMG, the principal marketer of the STARS transaction. KPMG and Sidley were also involved with putting the transaction together; therefore, KPMG and Sidley had an interest in the transaction and their advice was deemed suspect by the court.

The court also rejected reasonable reliance upon the opinion of PwC. PwC had not been tasked with reviewing the tax compliance of the STARS transaction. As a result, PwC did not provide a tax opinion. Even so, PwC explicitly informed Salem Financial that it was not providing an opinion regarding the larger transaction and had qualified its advice by suggesting a low level of comfort that the IRS would accept the STARS transaction.

Lastly, the court rejected a reasonable reliance defense because Salem Financial should have known that the STARS transaction was "too good to be true." The court reached this conclusion based on the education and experience of the company's executives. The court upheld the accuracy-related penalty but required reassessment of the amount to allow for interest deductions on part of the transaction.

No Affirmative Defense Offered by the Taxpayer

Many taxpayers offered no affirmative defense for the underpayment of tax, failing completely to claim the reasonable cause and good faith defense under IRC § 6664(c). Nearly two-thirds (21 cases out of 32 cases) of those failing to make an argument or present evidence of good faith were unrepresented in this reporting period.[63] The burden of proof to raise an affirmative defense is on the taxpayer and as a result, taxpayers must provide documentation to substantiate any disputed deductions or credits, explain why the records were inadequate, or show reliance on a tax professional.[64] When the taxpayer fails to present any evidence for an affirmative defense, courts may do a cursory examination of the *pro se* taxpayer's reliance on a tax professional.[65] While some *pro se* taxpayers may be unaware of the good faith exception, in many cases the taxpayer did not keep adequate records to support his or her position.[66]

An exception is *Nguyen v. Commissioner*, where evidence of reasonable reliance on the tax return preparer might have made a difference in the court's decision to impose the penalty under IRC § 6662.[67] The taxpayers, a married couple, were audited for TYs 2009 and 2010. The audit focused on the hardwood floor installation business owned and operated by Mr. Nguyen. A flood in the taxpayers' house destroyed some of Mr. Nguyen's records for 2009. Mr. Nguyen provided the surviving records to Mr. Wynn, a tax return preparer, who prepared a 2009 return for the taxpayers. Mr. Wynn reported cost of goods sold for Mr. Nguyen's business as $43,503 and supplies totaling $5,675. Mr. Wynn did not explain the difference between these two elements to the taxpayers. Ultimately, the IRS allowed only $18,095.66 for cost of

63 *See* Table 1 in Appendix 3, *infra*.

64 IRC § 7491(a). *See also* Tax Ct. R. 142(a).

65 *See, e.g.*, *Peterson v. Comm'r*, T.C. Memo. 2015-23, *appeal docketed*, No. 15-73092 (9th Cir. Oct. 8, 2015); *Smith v. Comm'r*, T.C. Memo. 2014-203.

66 *See, e.g.*, *Duong v. Comm'r*, T.C. Memo. 2015-90; *Flores v. Comm'r*, T.C. Memo. 2015-9.

67 T.C. Memo. 2014-199.

goods sold but did allow the entire amount claimed for supplies. The Nguyens used a different return preparer in 2010, but this preparer relied on the 2009 return in preparing the 2010 return. While the taxpayers' 2010 return claimed $39,894 for supplies, the IRS allowed only $24,668.26.

At trial, the Nguyens, who had representation, provided an incomplete bank statement for 2009 and some bank statements for 2010. They provided no additional testimony to substantiate expenses. The court allowed deductions equal to the amounts calculated by the IRS. The court then considered a reasonable cause defense prior to imposing a penalty on the Nguyens. First, the court determined that the 2009 flood could not be a reason for lack of substantiation because Mr. Nguyen had explained that most of his transactions would appear in his bank account statements, which he could have obtained for the trial.

The court then considered Mr. Nguyen's background. Mr. Nguyen had come to the United States from Vietnam and had obtained a ninth grade education. He had limited English skills but had successfully operated his business since 1997. Mr. Nguyen testified that he trusted Mr. Wynn and relied on his judgment. Mr. Wynn did not appear in court, despite the fact that Mr. Nguyen had issued him a subpoena to appear. However, Mr. Nguyen also did not submit any evidence to show Mr. Wynn's credibility or experience. Without this information, the taxpayers were unable to show that they relied on Mr. Wynn in good faith.

CONCLUSION

Over this last reporting period, the issue of accuracy-related penalties was decided by the courts in 113 cases. Litigation on the issue has continued to decline over the last two periods.[68]

Courts most often cited inadequate maintenance of records when imposing an accuracy-related penalty. When accepting a defense for reasonable cause and good faith, courts were most likely to cite reliance on a tax professional and manifestations of taxpayer efforts to comply with the tax code. About one-third of *pro se* taxpayers (21 cases out of 68 cases) and nearly one-fifth of represented taxpayers (11 cases out of 45 cases) failed to argue or present evidence of good faith.

As mentioned above, the IRS has the burden to prove the existence of an underpayment attributable to negligence/disregard of rules or regulations or an underpayment attributable to a substantial understatement.[69] However, if the taxpayer does not raise the issue of penalty assessment in the court pleadings, the taxpayer is deemed to have conceded the issue and the IRS is not required to provide evidence that the penalty is appropriate.[70] Likewise, the rules of the Tax Court require the taxpayer to include all arguments in the petition.[71]

Finally, it is important to note that Congress enacted law reversing the Tax Court's decision in *Rand v. Commissioner*, in which the Tax Court had held that refundable credits cannot reduce the amount shown as tax, by the taxpayer on a return, below zero.[72] IRC § 6664(a) was amended to be consistent with the rule of IRC § 6211(b)(4), which would allow the IRS to calculate negative tax in computing the amount

68 *See* National Taxpayer Advocate 2013 Annual Report to Congress 341 and National Taxpayer Advocate 2014 Annual Report to Congress 446.

69 IRC § 7491(c).

70 *Swain v. Comm'r*, 118 T.C. 358 (2002).

71 Tax Ct. R. 34(b)(4) ("Any issue not raised in the assignments of error shall be deemed to be conceded.").

72 Consolidated Appropriations Act, 2016, § 209 (2015). *See also Rand v. Comm'r*, 141 T.C. 376 (2013).

of underpayment for accuracy-related penalty purposes.[73] Thus, for returns filed after December 18, 2015, or for returns filed before that date for which the period of limitations on assessment under IRC § 6501 has not expired, a taxpayer can be subject to an underpayment penalty in IRC § 6662 based on a refundable credit which reduces tax below zero.

73 Consolidated Appropriations Act, 2016, § 209 (2015).

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

SUMMARY

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.[1] 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.

TAXPAYER RIGHTS IMPACTED[2]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*

PRESENT LAW

Internal Revenue Code (IRC) § 162 allows deductions for ordinary and necessary trade or business expenses paid or incurred during the course of a taxable year. Rules regarding the practical application of IRC § 162 have evolved largely from case law and administrative guidance. The IRS, the Department of the Treasury, Congress, and the courts continue to provide guidance about whether a taxpayer is entitled to claim certain deductions. The cases analyzed for this report illustrate that this process is ongoing and involves the analysis of facts and circumstances particular to each case. When a taxpayer seeks judicial review of the IRS's determination of a tax liability relating to the deductibility of a particular expense, the courts must often address a series of questions, including those discussed below.

What is a trade or business expense under IRC § 162?

Although "trade or business" is one of the most widely used terms in the IRC, neither the Code nor Treasury Regulations provide a definition.[3] The definition of a "trade or business" comes from common law, where the concepts have been developed and refined by the courts.[4] The Supreme Court has interpreted "trade or business" for purposes of IRC § 162 to mean an activity conducted with "continuity and regularity" and with the primary purpose of earning income or making profit.[5]

1 See National Taxpayer Advocate 1998-2014 Annual Reports to Congress.

2 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

3 In 1986, the term "trade or business" appeared in at least 492 subsections of the IRC and in over 664 Treasury Regulations. See F. Ladson Boyle, *What Is a Trade or Business?*, 39 Tax Law. 737 (Summer 1986).

4 Carol Duane Olson, *Toward a Neutral Definition of "Trade or Business" in the Internal Revenue Code*, 54 U. Cin. L. Rev. 1199 (1986).

5 *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

What is an ordinary and necessary expense?

IRC § 162(a) requires a trade or business expense to be both "ordinary" and "necessary" in relation to the taxpayer's trade or business to be deductible. In *Welch v. Helvering*, the Supreme Court stated that the words "ordinary" and "necessary" have different meanings, both of which must be satisfied for the taxpayer to benefit from the deduction.[6] The Supreme Court describes an "ordinary" expense as customary or usual and of common or frequent occurrence in the taxpayer's trade or business.[7] The Court describes a "necessary" expense as one that is appropriate and helpful for development of the business.[8]

Common law also requires that in addition to being ordinary and necessary, the amount of the expense must be reasonable for the expense to be deductible. In *Commissioner v. Lincoln Electric Co.*, the Court of Appeals for the 6th Circuit held "the element of reasonableness is inherent in the phrase 'ordinary and necessary.' Clearly it was not the intention of Congress to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount."[9]

Is the expense a currently deductible expense or a capital expenditure?

A currently deductible expense is an ordinary and necessary expense paid or incurred during the taxable year in the course of carrying on a trade or business.[10] No current deductions are allowed for the cost of acquisition, construction, improvement, or restoration of an asset expected to last more than one year.[11] Instead, those types of expenses are generally considered capital expenditures, which may be subject to depreciation, amortization, or depletion over the useful life of the property.[12]

Whether an expenditure is deductible under IRC § 162(a) or is a capital expenditure under IRC § 263 is a question of fact. Courts have adopted a case-by-case approach to applying principles of capitalization and deductibility.[13]

When is an expense paid or incurred during the taxable year, and what proof is there that the expense was paid?

IRC § 162(a) requires an expense to be "paid or incurred during the taxable year" to be deductible. The IRC also requires a taxpayer to maintain books and records that substantiate income, deductions, and credits, including adequate records to substantiate deductions claimed as trade or business expenses.[14] If a taxpayer cannot substantiate the exact amounts of deductions by documentary evidence (*e.g.*, invoice, paid bill, or canceled check) but can establish that he or she had some business expenditures, the courts may employ the *Cohan* rule to grant the taxpayer a reasonable amount of deductions.

6 290 U.S. 111, 115 (1933) (suggesting an examination of "life in all its fullness" will provide an answer to the issue of whether an expense is ordinary and necessary).

7 *Deputy v. du Pont*, 308 U.S. 488, 495 (1940) (citation omitted).

8 *See Comm'r v. Heininger*, 320 U.S. 467, 471 (1943) (citations omitted).

9 176 F.2d 815, 817 (6th Cir. 1949), *cert. denied*, 338 U.S. 949 (1950).

10 IRC § 162(a).

11 IRC § 263. *See also INDOPCO, Inc. v. Comm'r*, 503 U.S. 79 (1992).

12 IRC § 167.

13 *See PNC Bancorp, Inc. v. Comm'r*, 212 F.3d 822 (3d Cir. 2000); *Norwest Corp. v. Comm'r*, 108 T.C. 265 (1997).

14 IRC § 6001. *See also* Treas. Reg. §§ 1.6001-1 and 1.446-1(a)(4).

The *Cohan* rule

The *Cohan* rule is one of "indulgence" established in 1930 by the Court of Appeals for the 2nd Circuit in *Cohan v. Commissioner*.[15] The court held that the taxpayer's business expense deductions were not adequately substantiated, but stated that "the [Tax Court] should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent."[16] In *Estate of Elkins v. Commissioner*, the 5th Circuit recently described "the venerable lesson of Judge Learned Hand's opinion in *Cohan*: In essence, make as close an approximation as you can, but never use a zero."[17]

The *Cohan* rule cannot be used in situations where IRC § 274(d) applies. IRC § 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deductions are allowable for:

- Travel expenses;
- Entertainment, amusement, or recreation expenses;
- Gifts; and
- Certain "listed property."[18]

A taxpayer must substantiate a claimed IRC § 274(d) expense with adequate records or sufficient evidence to establish the amount, time, place, and business purpose.[19] A contemporaneous log is not explicitly required, but a statement not made at or near the time of the expenditure has the same degree of credibility only if the corroborative evidence has "a high degree of probative value."[20] In addition, entertainment expenses require proof of a business relationship to the taxpayer.[21]

Who has the burden of proof in a substantiation case?

Generally, the taxpayer bears the burden of proving that he or she is entitled to the business expense deductions and the IRS's proposed determination of tax liability is incorrect.[22] IRC § 7491(a) provides that the burden of proof shifts to the IRS when the taxpayer:

- Introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer's liability;
- Complies with the requirements to substantiate deductions;

15 39 F.2d 540 (2d Cir. 1930). George M. Cohan was an actor, playwright, and producer who spent large sums travelling and entertaining actors, employees, and critics. Although Cohan did not keep a record of his spending on travel and entertainment, he estimated that he incurred $55,000 in expenses over several years. The Board of Tax Appeals, now the Tax Court, disallowed these deductions in full based on Cohan's lack of supporting documentation. Nevertheless, on appeal, the 2nd Circuit concluded that Cohan's testimony established that legitimate deductible expenses had been incurred. As a result, the 2nd Circuit remanded the case back to the Board of Tax Appeals with instructions to estimate the amount of deductible expenses.

16 39 F.2d 540 (2d Cir. 1930) at 544 (2d Cir. 1930), *aff'g and remanding* 11 B.T.A. 743 (1928).

17 767 F.3d 443, 449, n. 7 (5th Cir. 2014), *rev'g* 140 T.C. 86 (2013).

18 "Listed property" means any passenger automobile; any property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; any computer or peripheral equipment (except when used exclusively at a regular business establishment and owned or leased by the person operating such establishment); and any other property specified by regulations. IRC §§ 280F(d)(4)(A) and (B).

19 Treas. Reg. § 1.274-5T(b).

20 Treas. Reg. § 1.274-5T(c)(1); *Reynolds v. Comm'r*, 296 F.3d 607, 615-16 (7th Cir. 2002) (noting that keeping written records is not the only method to substantiate IRC § 274 expenses but "alternative methods are disfavored").

21 Treas. Reg. § 1.274-5T(b)(3)(v).

22 *See Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted) and U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

- Maintains all records required under the Code; and
- Cooperates with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews.

ANALYSIS OF LITIGATED CASES

The deductibility of trade or business expenses has been one of the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998.[23] This year, we reviewed 99 cases involving trade or business expenses that were litigated in federal courts from June 1, 2014, through May 31, 2015. Table 2 in Appendix 3 contains a list of the main issues in those cases. Figure 3.2.1 categorizes the main issues raised by taxpayers. Cases involving more than one issue are included in more than one category.

FIGURE 3.2.1, Trade or Business Expense Issues in Cases Reviewed[24]

Issue	Type of Taxpayer	
	Individual	Business
Substantiation of Expenses, Including Application of the *Cohan* Rule	14	60
Ordinary and Necessary Trade or Business Expenses	1	11
Personal vs. Business Expense	4	19
Trade or Business Carried on for Profit	2	19
Economic Substance	0	4
Home Office	1	10

Taxpayers represented themselves (*pro se*) in 60 of 99 cases. Taxpayers represented by counsel (39 of 99 cases) fared slightly better than their *pro se* counterparts. Taxpayers with representation received full or partial relief in approximately 49 percent of cases (19 of 39). By contrast, *pro se* taxpayers received full or partial relief in 38 percent of cases (23 of 60).

Individual Taxpayers

None of the 16 decisions involving individual taxpayers (where the term "individual" excludes a sole proprietorship) were issued as a regular opinion of the Tax Court.[25] Eleven of the 16 individual taxpayers appeared *pro se*. Two individual taxpayers received full relief, while nine earned split decisions. The court fully upheld the IRS position in five of 16 cases (31 percent).

23 See National Taxpayer Advocate 1998-2014 Annual Reports to Congress.

24 Multiple issues can appear within one case; therefore, these issue-spotting breakdown figures will not match the total case count.

25 Tax Court decisions fall into three categories: regular decisions, memorandum decisions, and small tax case ("S") decisions. The regular decisions of the Tax Court include cases which have some new or novel point of law, or in which there may not be general agreement, and therefore have the most legal significance. In contrast, memorandum decisions generally involve fact patterns within previously settled legal principles and therefore are not as legally significant. Finally, "S" case decisions (for disputes involving $50,000 or less where the taxpayer has elected Small Case status) are not appealable and, thus, have no precedential value. *See* IRC § 7463(b). *See also* U.S. Tax Court Rules of Practice and Procedure, Rules 170-175. More than half of the cases reviewed this year involving individual taxpayers (excluding sole proprietorships) were "S" cases.

The most prevalent issue was the substantiation of claimed trade or business expense deductions. For example, in *Garza v. Commissioner*, the Tax Court denied a travel expense deduction for failure to substantiate.[26] The taxpayer, a direct sales representative for Time Warner Cable, used his personal vehicle to make service calls and maintained a calendar planner in which he recorded his vehicle's odometer readings at the beginning and end of each month, sometimes also including intermediate readings and personal notes. Although the taxpayer's calendar planner was contemporaneous, it lacked information detailing the amount, date, and business purpose of each use of his vehicle. As a result, the Court denied the taxpayer a deduction for these claimed travel expenses.[27]

Business Taxpayers

We reviewed 83 cases involving business taxpayers. As it turned out, business taxpayers had a much lower success rate compared to individual taxpayers. Individual taxpayers received full or partial relief in approximately 69 percent of cases (11 of 16). Meanwhile, business taxpayers received full or partial relief in only 37 percent of cases (31 of 83).

Business taxpayers were represented by counsel in 55 percent (17 of 31) of favorably decided cases, including eight cases in which the taxpayer received full relief. Business taxpayers were represented by counsel in 33 percent (17 of 52) of the cases the IRS won. To the extent that *pro se* taxpayers were successful in court, these favorable outcomes stemmed mostly from their ability to provide records substantiating deductions in cases where such substantiation was in controversy.

As was the case for the individual taxpayers, substantiation of expenses was by far the most prevalent issue, and in most instances, the courts denied the business taxpayers' deductions for failure to substantiate.[28] Courts did, however, allow some of these deductions when the taxpayer produced sufficient evidence.[29] Courts occasionally applied the *Cohan* rule where the taxpayer presented sufficient documentation to prove an expense was incurred but had limited documentation of the precise amount.[30] As previously mentioned, however, IRC § 274(d) makes the *Cohan* rule unavailable in certain circumstances in which the taxpayer must substantiate the deductions.

Taxpayers were also denied business expense deductions under IRC § 262(a) when the courts found the expenses were related to personal rather than business activities.[31] In *Peterson v. Commissioner*, the taxpayer was a full-time police officer for the city of Chicago and also owned and operated a private security company.[32] The taxpayer claimed deductions for vehicle, transportation, and travel expenses resulting

26 T.C. Memo. 2014-121.

27 *See also Flores v. Comm'r*, T.C. Memo. 2015-9 (denying deductions for vehicle and other Schedule A expenses for insufficient or absent documentation).

28 *See Sheridan v. Comm'r*, T.C. Memo. 2015-25 (finding that taxpayer was not entitled to annual theft loss deductions of $1 million for alleged smokeless tobacco vaporizer patent infringement); *Robinson v. Comm'r*, T.C. Memo. 2014-120, *aff'd*, No. 15-1380 (4th Cir. Sept. 3, 2015) (denying deductions for vehicle, home office, and other personal expenses).

29 *See ABC Beverage Corp. v. U.S.*, 756 F.3d 438 (6th Cir. 2014), *aff'g* 577 F. Supp. 2d 935 (W.D. Mich. 2008) (holding that a portion of the purchase price from a burdensome lease buyout was deductible); *Cooper v. Comm'r*, 143 T.C. 194 (2014) (finding that reverse engineering expenses were sufficiently related to taxpayer's business as an inventor and were deductible as a result), *appeal docketed*, No. 15-70863 (9th Cir. Mar. 20, 2015).

30 *See Mylander v. Comm'r*, T.C. Memo. 2014-191 (allowing deduction for continuing dental education based on approximated expense of class hour and annual education requirement); *Sawyer v. Comm'r*, T.C. Memo. 2015-55 (allowing deduction for labor costs approximated from taxpayer's testimony and invoices).

31 IRC § 262(a) provides that personal, living, and family expenses are generally not deductible. *See, e.g.*, *Lussy v. Comm'r*, T.C. Memo. 2015-35 (denying deductions for legal fees, travel, and other expenses personal in nature), *appeal docketed*, No. 15-11626 (11th Cir. Apr. 13, 2015).

32 T.C. Memo. 2015-23.

from his off-duty work activities. He also deducted expenses for meals and entertainment, an additional bulletproof vest, and classes towards a master's degree in emergency management.

The Tax Court did not allow deductions for an additional bullet proof vest or expenses towards the taxpayer's master degree as these expenses were personal in nature.[33] Similarly, the Tax Court found that the taxpayer failed to substantiate travel, meal, and entertainment expenses to the strict degree required by IRC § 274(d). As a result, no deductions whatsoever were allowed.

Similarly, in *Engstrom, Lipscomb & Lack, APC v. Commissioner*, a law firm (Engstrom) challenged the IRS's disallowance of business-related air travel expenses.[34] The Tax Court denied all deductions for flights where no Engstrom personnel were present because they lacked a business purpose and failed to meet the strict IRC § 274(d) substantiation requirements. By contrast, the substantiation requirements and other prerequisites for deductibility, such as a business purpose, were held to have been satisfied with respect to many of the air travel expenses for flights on which the firm's owner or employees were passengers.[35]

Courts likewise generally sustained IRS determinations that business expense deductions were not attributable to an activity engaged in for profit within the meaning of IRC § 183. However, in *Crile v. Commissioner*, the taxpayer successfully established that she engaged in art making as a for profit business activity.[36] To arrive at this determination, the Tax Court proceeded to examine the taxpayer's deductions using the nine-factor test of Treas. Reg. § 1.183-2(b).[37]

The Tax Court stated that the taxpayer's business plan, credentials as an artist, time and effort spent on her art business, and the expectation of appreciation in the value of her artwork weighed in favor of her art making being for profit. According to the Court, these factors weighed more heavily in favor of the taxpayer's art making being for profit than the fact that she earned profits in only two of the multiple years in which she claimed deductions.[38]

Another common theme was the difficulty in proving that expenses were ordinary and necessary to the taxpayer's business.[39] The Tax Court in *Guardian Industries Corp. v. Commissioner* denied the taxpayer a deduction for a fine it paid to the Commission of the European Community (the Commission).[40] Guardian Industries and its Luxembourg subsidiary manufactured and sold fabricated-glass products. The Commission began an investigation of Guardian Industries and ultimately concluded that Guardian

33 39 F.2d 540 (2d Cir. 1930).

34 *Engstrom, Lipscomb & Lack, APC v. Comm'r*, T.C. Memo. 2014-221, *appeal docketed*, No. 15-70591 (9th Cir. Feb. 26, 2015).

35 For a more detailed discussion of this case, see Most Litigated Issue: *Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)*, *supra*.

36 T.C. Memo. 2014-202.

37 Those factors are (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

38 *Crile*, T.C. Memo. 2014-202.

39 *See* IRC § 162(a). For examples of cases examined in which the court denied deductions for failure to prove the expense was ordinary and necessary to the taxpayer's business, *see*, *e.g.*, *Fargo v. Comm'r*, T.C. Memo. 2015-96 (holding that payments made by the taxpayer's S corporation were not ordinary and necessary business expenses and therefore not deductible); *Midwest Eye Ctr., S.C. v. Comm'r*, T.C. Memo. 2015-53 (holding that taxpayer's $1 million bonus to sole executive and shareholder was not an ordinary and necessary business expense because it was not reasonable).

40 143 T.C. 1 (2014).

Industries had engaged in a cartel with its subsidiary, violating a European treaty on price fixing. A fine was issued against Guardian Industries as a result.

Guardian Industries attempted to deduct the fine it paid to the Commission as an "ordinary and necessary" business expense under IRC § 162. The IRS denied Guardian Industries this deduction, explaining that the fine paid to the Commission was more appropriately categorized as a non-deductible "fine or similar penalty paid to a government for the violation of any law."[41] The Tax Court agreed, ruling that the Commission is an "entity serving as an agency or instrumentality" of "[t]he government of a foreign country," and holding that the fine paid by Guardian Industries to the Commission therefore was not a deductible "ordinary and necessary" business expense.[42]

Taxpayers also had difficulty validating their home office deductions, losing cases where business use of a personal residence was in question.[43] One example of this issue was *Longino v. Commissioner*, where the taxpayer, an attorney, sought to claim a number of IRC § 162 expenses, including home office deductions for the use of his apartment.[44] The taxpayer, however, failed to substantiate that he used the apartment exclusively as his principal place of business, as his testimony provided "almost no details" about business activities conducted in the rooms in question.[45] Consequently, the 11th Circuit affirmed the denial of the home office expense deductions on appeal.

Another issue addressed by the courts this year deals with the question of whether a transaction has economic substance, which is a prerequisite for deductibility.[46] For example, in *Reddam v. Commissioner*, the taxpayer sought to offset his potential tax liability from the sale of a company he founded.[47] To realize this offset, the taxpayer engaged in the trading of foreign bank stock through a series of interrelated entities. The culmination of these trades and transactions created a sizable capital loss that the taxpayer sought to claim for tax purposes. In 2001, however, the IRS had announced it would not recognize tax benefits from the type of transactions in which the taxpayer had engaged.[48] The Tax Court held that the taxpayer was not entitled to claim the capital loss at issue, and the taxpayer appealed.

On appeal, the 9th Circuit utilized the "economic substance doctrine" to determine if the taxpayer's claimed capital loss should be disregarded for income tax purposes.[49] The court concluded from the facts of the case that the taxpayer pursued his foreign bank stock transactions solely for their tax benefits and that any potential economic gain from these transactions was vastly outweighed by their designed purpose

41 IRC § 162(f).

42 *Guardian Indus.*, 143 T.C. 1, 20 (2014). Treas. Reg. § 1.162-21(a) states that "[n]o deduction shall be allowed under section 162(a) for any fine or similar penalty paid to— (1) The government of the United States, a State, a territory or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico; (2) The government of a foreign country; or (3) A political subdivision of, or corporation or other entity serving as an agency or instrumentality of, any of the above."

43 IRC § 280(A)(c)(1) allows the deduction of "a portion of the dwelling unit which is exclusively used on a regular basis… as the principal place of business for any trade or business of the taxpayer." If the taxpayer is an employee, the home office deduction is only allowable if the exclusive use is for the convenience of the employer.

44 *Longino v. Comm'r*, 593 F. App'x 965 (11th Cir. 2014), *aff'g* T.C. Memo. 2013-80.

45 *Id.* at 969.

46 Taxpayers lost all four cases focused on the economic substance inquiry. *See Reddam v. Comm'r*, 755 F.3d 1051 (9th Cir. 2014), *aff'g* T.C. Memo. 2012-106; *Kenna Trading, LLC v. Comm'r*, 143 T.C. No. 18 (2014) (disallowing deductions for bad debt derived from sham partnership that lacked economic substance); *Vanney Assocs., Inc. v. Comm'r*, T.C. Memo. 2014-184 (holding that the taxpayer's payment of year-end bonus to shareholder-CEO was not deductible as officer compensation); *Graffia v. Comm'r*, 580 F. App'x 474 (7th Cir. 2014), *aff'g* T.C. Memo. 2013-211 (denying deductions for flow-through losses from sham transactions that lacked economic substance).

47 755 F.3d 1051 (9th Cir. 2014), *aff'g* T.C. Memo. 2012-106.

48 IRS Notice 2001-45, 2001-2 C.B. 129.

49 *Reddam*, 755 F.3d at 1059.

of creating capital losses. As a result, the court held that these transactions lacked economic substance and therefore the capital loss was not deductible.

CONCLUSION

The existence and amounts of allowable business expenses are highly fact-specific and are often open to interpretation. This circumstance continues to generate substantial controversy between the IRS and taxpayers regarding the scope and extent of properly claimed business deductions. This year, as in prior years, the IRS actively scrutinized and challenged many such deductions, while taxpayers were often willing to resort to litigation where the disallowance could not be resolved administratively within the IRS. From June 1, 2014, through May 31, 2015, courts generally favored the IRS's denial of business expense deductions, but specific facts and circumstances yielded some victories for taxpayers.

Eleven of these full or partial victories by taxpayers involved the courts' application of the *Cohan* rule. Use of this common law doctrine allowed taxpayers to deduct estimated expenses in cases where the expenses clearly existed but where available documentation made certainty regarding the amount of these expenses difficult or impossible. The IRS Office of Appeals also utilizes the *Cohan* rule in assessing hazards of litigation and in seeking to reach settlements with taxpayers.[50] The Examination process that often leads to Appeals, however, does not employ the *Cohan* rule and has adopted a more stringent document request policy to close cases and bypass Appeals in several instances.[51]

Given the relative frequency of business expense substantiation litigation, we recommend that IRS Compliance functions adopt the *Cohan* rule as a tool for evaluating and resolving tax controversies. This step would reduce potential hazards of litigation that the IRS may face and would lead to a higher rate of mutually beneficial settlements at the earliest possible stage of administrative proceedings. By embracing the opportunities for education, outreach, and collaboration with stakeholders that increased use of the *Cohan* rule would bring, the IRS can help taxpayers better understand business expense deductions and can effectively reduce the costly litigation to which both taxpayers and the government are currently subject. This education, outreach, and collaboration likewise would promote taxpayers' *right to be informed* and *right to challenge the IRS's position and be heard*.

50 *See* National Taxpayer Advocate 2015 Annual Report to Congress (Most Serious Problem: *Appeals: The Appeals Judicial Approach and Culture Project Is Reducing The Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*), *supra*.

51 *Id.*

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

SUMMARY

Pursuant to Internal Revenue Code (IRC) § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability.[1] To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information.[2] 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.[3]

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it.[4] Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because often 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.[5] Generally, the burden on the taxpayer to establish the illegality of the summons is heavy.[6] When challenging the summons's validity, the taxpayer generally must provide "some credible evidence" supporting an allegation of bad faith or improper purpose.[7] 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.[8] Naked allegations of improper purpose are not enough, but because direct evidence of IRS's bad faith "is rarely if ever available," circumstantial evidence can suffice to meet that burden.[9]

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.

TAXPAYER RIGHTS IMPACTED[10]

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

1 IRC § 7602(a)(1); Treas. Reg. § 301.7602-1.
2 IRC § 7602(a).
3 IRC § 7604(b).
4 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).
5 IRC § 7609(b).
6 *U.S. v. LaSalle Nat'l Bank*, 437 U.S. 298, 316 (1978).
7 *U.S. v. Clarke*, 134 S. Ct. 2361, 2367 (2014), *vacating* 517 F. App'x 689 (11th Cir. 2013), *rev'g* 2012-2 U.S. Tax Cas. (CCH) ¶ 50,732 (S.D. Fla. 2012).
8 *Id.* (stating that "[t]he taxpayer need only make a showing of facts that give rise to a plausible inference of improper motive").
9 *Id.* at 2367-68.
10 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

PRESENT LAW

The IRS has broad authority under IRC § 7602 to issue a summons to examine a taxpayer's books and records or demand testimony under oath.[11] Further, the IRS may obtain information related to an investigation from a third party if, subject to the exceptions of IRC § 7609(c), it provides notice to the taxpayer or other person identified in the summons.[12] In limited circumstances, the IRS can issue a summons even if the name of the taxpayer under investigation is unknown, *i.e.*, a "John Doe" summons.[13] However, the IRS cannot issue a summons after referring the matter to the Department of Justice (DOJ).[14]

If the recipient fails to comply with a summons, the United States may commence an action under IRC § 7604 in the appropriate U.S. District Court to compel document production or testimony.[15] If the United States files a petition to enforce the summons, the taxpayer may contest the validity of the summons in that proceeding.[16] Also, if the summons is served upon a third party, any person entitled to notice may petition to quash the summons in an appropriate district court, and may intervene in any proceeding regarding the enforceability of the summons.[17]

Generally, a taxpayer or other person named in a third-party summons is entitled to notice.[18] However, the IRS does not have to provide notice in certain situations. For example, the IRS is not required to give notice if the summons is issued to aid in the collection of "an assessment made or judgment rendered against the person with respect to whose liability the summons is issued."[19] Congress created this exception because it recognized a difference between a summons issued in an attempt to compute the taxpayer's taxable income and a summons issued after the IRS has assessed tax or obtained a judgment.

For example, the IRS does not have to give notice to the taxpayer or person named in the summons if it is attempting to determine whether the taxpayer has an account in a certain bank with sufficient funds to pay an assessed tax because such notice might seriously impede the IRS's ability to collect the tax.[20] Courts have interpreted this "aid in collection" exception to apply only if the taxpayer owns a legally identifiable interest in the account or other property for which records are summoned.[21] Additionally,

11 IRC § 7602(a). *See also LaMura v. U.S.*, 765 F.2d 974, 979 (11th Cir. 1985) (citing *U.S. v. Bisceglia*, 420 U.S. 141, 145-46 (1975)).

12 IRC § 7602(c). Those entitled to notice of a third-party summons (other than the person summoned) must be given notice of the summons within three days of the day on which the summons is served to the third party but no later than the 23rd day before the day fixed on the summons on which the records will be reviewed. IRC § 7609(a).

13 The court must approve a "John Doe" summons prior to issuance. In order for the court to approve the summons, the United States commences an *ex parte* proceeding. The United States must establish during the proceeding that its investigation relates to an ascertainable class of persons; it has a reasonable basis for the belief that these unknown taxpayers may have failed to comply with the tax laws; and it cannot obtain the information from another readily available source. IRC § 7609(f).

14 IRC § 7602(d). This restriction applies to "any summons, with respect to any person if a [DOJ] referral is in effect with respect to such person." IRC § 7602(d)(1).

15 IRC § 7604.

16 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

17 IRC § 7609(b). The petition to quash must be filed not later than the 20th day after the date on which the notice was served. IRC § 7609(b)(2)(A).

18 IRC § 7609(a)(1); Treas. Reg. § 301.7609-1(a)(1). *See, e.g.*, *Cephas v. U.S.*, 112 A.F.T.R.2d (RIA) 6483 (D. Md. 2013).

19 IRC § 7609(c)(2)(D)(i). The exception also applies to the collection of a liability of "any transferee or fiduciary of any person referred to in clause (i)." IRC § 7609(c)(2)(D)(ii).

20 H.R. Rep. No. 94-658, at 310, *reprinted in* 1976 U.S.C.C.A.N. at 3206. *See also* S. Rep. No. 94-938, pt. 1, at 371, *reprinted in* 1976 U.S.C.C.A.N., at 3800-01 (containing essentially the same language).

21 *Ip v. U.S.*, 205 F.3d 1168, 1172-76 (9th Cir. 2000).

the IRS is not required to give notice when, in connection with a criminal investigation, an IRS criminal investigator serves a summons on any person who is not the third-party record-keeper.[22]

Whether the taxpayer contests the summons in a motion to quash or in response to the United States' petition to enforce, the legal standard is the same.[23] In *United States v. Powell*, the Supreme Court set forth four threshold requirements (referred to as the *Powell* requirements) that must be satisfied to enforce an IRS summons:

1. The investigation must be conducted for a legitimate purpose;
2. The information sought must be relevant to that purpose;
3. The IRS must not already possess the information; and
4. All required administrative steps must have been taken.[24]

The IRS bears the initial burden of establishing that these requirements have been satisfied.[25] The government meets its burden by providing a sworn affidavit of the agent who issued the summons declaring that each of the *Powell* requirements has been satisfied.[26] The burden then shifts to the person contesting the summons to demonstrate that the IRS did not meet the requirements or that enforcement of the summons would be an abuse of process.[27]

The taxpayer can show that enforcement of the summons would be an abuse of process if he or she can prove that the IRS issued the summons in bad faith.[28] In *United States v. Clarke*, the Supreme Court held that during a summons enforcement proceeding, a taxpayer has a right to conduct an examination of the responsible IRS officials about whether a summons was issued for an improper purpose only when the taxpayer "can point to specific facts or circumstances plausibly raising an inference of bad faith."[29] Blanket claims of improper purpose are not sufficient, but circumstantial evidence can be.[30]

A taxpayer may also allege that the information requested is protected by a constitutional, statutory, or common-law privilege, such as the:

- Fifth Amendment privilege against self-incrimination;
- Attorney-client privilege;[31]

22 IRC § 7609(c)(2)(E). A third-party record-keeper is broadly defined and includes banks, consumer reporting agencies, persons extending credit by credit cards, brokers, attorneys, accountants, enrolled agents, and owners or developers of computer source code but only when the summons "seeks the production of the source or the program or the data to which the source relates." IRC § 7603(b)(2).

23 *Kamp v. U.S.*, 112 A.F.T.R.2d (RIA) 6630 (E.D. Cal. 2013).

24 *U.S. v. Powell*, 379 U.S. 48, 57-58 (1964).

25 *Fortney v. U.S.*, 59 F.3d 117, 119-20 (9th Cir. 1995).

26 *U.S. v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993).

27 *Id*.

28 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

29 *U.S. v. Clarke*, 134 S. Ct. 2361, 2367 (2014), *vacating* 517 F. App'x 689 (11th Cir. 2013), *rev'g* 2012-2 U.S. Tax Cas. (CCH) ¶ 50,732 (S.D. Fla. 2012).

30 *Id*. at 2367-68.

31 The attorney-client privilege provides protection from discovery of information where: (1) legal advice of any kind is sought, (2) from a professional legal advisor in his or her capacity as such, (3) the communication is related to this purpose, (4) made in confidence, (5) by the client, (6) and at the client's insistence protected, (7) from disclosure by the client or the legal advisor, (8) except where the privilege is waived. *U.S. v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing 8 John Henry Wigmore, Evidence in Trials at Common Law § 2292 (John T. McNaughten rev. 1961)).

- Tax practitioner privilege;[32] or
- Work product privilege.[33]

However, these privileges are limited. For example, courts reject blanket assertions of the Fifth Amendment,[34] but note that taxpayers may have valid Fifth Amendment claims regarding specific documents or testimony.[35] However, even if a taxpayer may assert the Fifth Amendment on behalf of him or herself, he or she cannot assert it on behalf of a business entity.[36]

Additionally, taxpayers cannot, on the basis of the Fifth Amendment privilege, withhold self-incriminatory evidence of a testimonial or communicative nature if the summoned documents fall within the "foregone conclusion" exception to the Fifth Amendment. The exception applies if the government establishes its independent knowledge of three elements:

1. The documents' existence;
2. The documents' authenticity; and
3. The possession or control of the documents by the person to whom the summons was issued.[37]

The attorney-client privilege protects "tax advice," but not tax return preparation materials.[38] The "tax shelter" exception limits the tax practitioner privilege and permits discovery of communications between a practitioner and client that promote participation in any tax shelter.[39] Thus, the tax practitioner privilege does not apply to any written communication between a federally authorized tax practitioner and "any person, any director, officer, employee, agent, or representative of the person, or any other person holding a capital or profits interest in the person" which is "in connection with the promotion of the direct or indirect participation of the person in any tax shelter."[40]

In June 2014, the IRS issued temporary regulations providing that outside parties hired by the IRS may receive and examine any summoned books, papers, records, or other data and may take testimony of any

32 IRC § 7525 extends the protection of the common law attorney-client privilege to federally authorized tax practitioners in federal tax matters. Criminal tax matters and communications regarding tax shelters are exceptions to the privilege. IRC § 7525(a)(2), (b). The interpretation of the tax practitioner privilege is based on the common law rules of attorney-client privilege. *U.S. v. BDO Seidman, LLP*, 337 F.3d 802, 810-12 (7th Cir. 2003).

33 The work product privilege protects against the discovery of documents and other tangible materials prepared in anticipation of litigation. Fed. R. Civ. P. 26(b)(3); *see also Hickman v. Taylor*, 329 U.S. 495 (1947).

34 *See, e.g.*, *U.S. v. McClintic*, 113 A.F.T.R.2d (RIA) 330 (D. Or. 2013).

35 *See, e.g.*, *U.S. v. Lawrence*, 113 A.F.T.R.2d (RIA) 1933 (S.D. Fla. 2014).

36 *See, e.g.*, *U.S. v. Ali*, 113 A.F.T.R.2d (RIA) 1863 (D. Md. 2014) (citing *U.S. v. Wujkowski*, 929 F.2d 981, 983 (4th Cir. 1991)).

37 *U.S. v. Bright*, 596 F.3d 683, 692 (9th Cir. 2010).

38 *U.S. v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999).

39 IRC § 7525(b). *See also Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009).

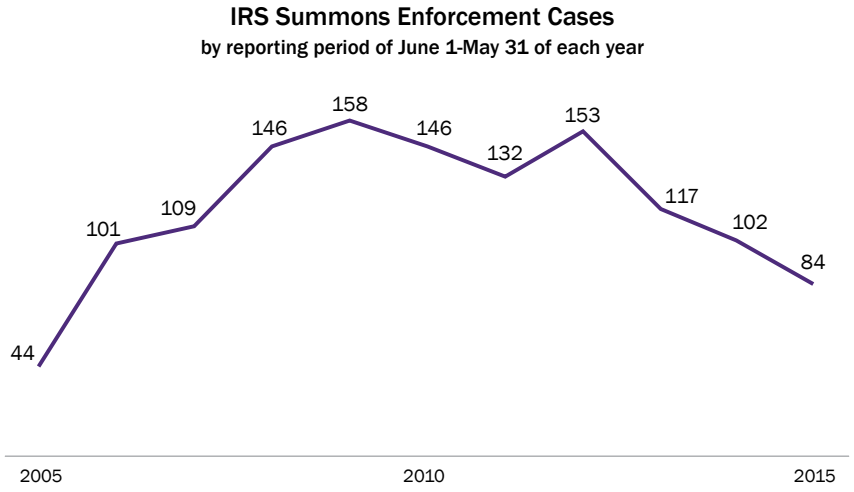
40 *Id*.

summoned person under oath.[41] These outside parties are also permitted to fully participate in a summons interview.[42]

ANALYSIS OF LITIGATED CASES

Summons enforcement has been a Most Litigated Issue in the National Taxpayer Advocate's Annual Report to Congress every year since 2005, when TAS identified only 44 cases but predicted the number would rise as the IRS became more aggressive in its enforcement initiatives. The number of cases peaked at 158 for the reporting period ending on May 31, 2009, but has steadily declined, except for a one-year increase for the year ending May 31, 2012, as shown in Figure 3.3.1. This year, the decline in the number of summons enforcement cases continues, as we identified 84 cases for the reporting period ending on May 31, 2015, a drop from the 102 cases during last year's reporting period. A detailed list of these cases appears in Table 3 of Appendix 3.

FIGURE 3.3.1, Summons Enforcement Cases, 2005–2015



Of the 84 cases TAS reviewed this year, the IRS prevailed in full in 81, a 96 percent success rate. Taxpayers had representation in 23 cases and appeared *pro se* (*i.e.*, on their own behalf) in the

41 Temp. Treas. Reg. § 301.7602-1T(b)(3). There is notable current summons enforcement litigation involving the IRS's use of an outside law firm in an audit of Microsoft Corporation's transfer pricing arrangements. *See* Dolores W. Gregory, *Transfer Pricing: Microsoft Pushes for Evidentiary Hearing, Cites IRS's 'Illegal' Deal With Quinn Emanuel*, Tax Notes Today (Apr. 27, 2015). Although it is outside of the reporting period for the Most Litigated Issues section, Microsoft was successful in obtaining an evidentiary hearing in the summons enforcement case. *See U.S. v. Microsoft Corp.*, 2015 WL 4496749 (W.D. Wash. 2015). Commentators have come out both for and against the IRS's use of outside attorneys in cases such as Microsoft's. *Cf.* Roger A. Pies, *IRS Prerogative to Hire Outside Counsel*, Tax Notes Today (July 7, 2015) (arguing that the IRS should be allowed to retain outside counsel in a big document case) and Stuart Gibson, *If the IRS needs Good Lawyers, it Should Look Across the Street*, Tax Notes Today (Mar. 30, 2015) (questioning why the IRS did not seek assistance from the DOJ in the Microsoft case).

42 Temp. Treas. Reg. § 301.7602-1T(b)(3). The regulations provide that full participation includes, but is not limited to, receipt, review, and use of summoned materials, being present during summons interviews, questioning the person giving testimony, and asking the summoned person's representative to clarify an objection or assertion of a privilege. These temporary regulations went into effect for all summons interviews held on or after June 18, 2014 and will expire on June 16, 2017.

remaining 61. Sixty-four cases involved individual taxpayers, while the remaining 20 involved business taxpayers, including sole proprietorships.[43] Cases generally involved one of the following themes.

Petitions to Enforce and *Powell* Requirements

The United States petitioned to enforce a summons in 59 cases and successfully met its burden under *Powell* in 58 cases. In only one case, *United States v. Taylor*, did the IRS fail to satisfy the *Powell* requirements.[44] In *Taylor*, the IRS was investigating the taxpayer for the collection of tax liabilities for the taxable year ending December 31, 2007.[45] However, the revenue officer issued a summons for all documents and records from December 1, 2013 to present.[46] The district court declined to enforce the summons and held that the IRS did not meet the relevance prong of the *Powell* requirements because the documents requested were not necessary to determine the taxpayer's tax liability for 2007.[47]

Abuse of Process

Several taxpayers claimed that the IRS issued summonses in bad faith or for an improper purpose, and therefore enforcement would be an abuse of the court's process.[48] However, taxpayers were unsuccessful proving either bad faith or improper purpose because they were unable to allege facts and circumstances that could plausibly imply bad faith. For example, in *United States v. Artex Risk Solutions, Inc.*, one of the taxpayer's claims of bad faith was that the IRS did not provide reasonable deadlines to produce the necessary information.[49] The court held that the summons was not issued in bad faith because the taxpayer failed to substantiate its claims as to the burdens it faced to comply with the summonses and did not show that IRS deadlines were unreasonable.[50]

Petitions to Quash and Lack of Subject Matter Jurisdiction

Taxpayers petitioned to quash an IRS summons to a third party in 26 instances;[51] however, in 13 of these cases, courts dismissed the petitions for lack of jurisdiction on procedural or notice grounds.[52] For example, a court dismissed a *pro se* taxpayer's petition to quash for lack of jurisdiction because the taxpayer filed the petition more than 60 days after the IRS had issued the summons.[53] Another court dismissed a *pro se*

43 There were cases in which the IRS issued summons for investigations into both the individual taxpayer and his or her business. For the purposes of this MLI, TAS placed these cases into the business taxpayer category.

44 *U.S. v. Taylor*, 115 A.F.T.R.2d (RIA) 1165 (C.D. Cal. 2015).

45 *Id*.

46 *Id*.

47 *Id*. The court stated that the Government could amend its Petition and Declaration to establish a "realistic expectation" of potential relevance for the requested information.

48 *See U.S. v. Anderson*, 114 A.F.T.R.2d (RIA) 6731 (N.D. Cal. 2014), *stay denied*, 115 A.F.T.R.2d (RIA) 468 (N.D. Cal. 2015), *appeal docketed*, No. 15-15130 (9th Cir. Jan. 26, 2015); *U.S. v. Artex Risk Solutions, Inc.*, 2014 U.S. Dist. LEXIS 126932 (N.D. Ill. 2014); *Haw. Pac. Fin., Ltd. v. U.S.*, 114 A.F.T.R.2d (RIA) 5640 (D. Haw. 2014; *Highland Capital Mgmt., L.P. v. U.S.*, 51 F. Supp. 3d 544 (S.D.N.Y. 2014), *aff'd in part and vacated in part*, 2015 U.S. App. LEXIS 17112 (2d Cir. 2015); *Schwartz v. U.S.*, 115 A.F.T.R.2d (RIA) 1942 (S.D. Fla. 2015).

49 *U.S. v. Artex Risk Solutions, Inc.*, 2014 U.S. Dist. LEXIS 126932, at *14-15 (N.D. Ill. 2014).

50 *Id*. at *15.

51 In some instances, the taxpayer made the motion to quash in its answer to the government's petition to enforce.

52 In 13 of the 26 cases, the petitions to quash were denied on substantive grounds.

53 *Abusch v. U.S.*, 114 A.F.T.R.2d (RIA) 5535 (M.D. La. 2014), *adopting* 114 A.F.T.R.2d (RIA) 5533 (M.D. La. 2014), *cert. denied*, No. 14-948 (Mar. 23, 2015). Under IRC § 7609(b)(2)(A), a taxpayer seeking to quash a third-party summons must file a petition with the appropriate district court within 20 days after the date the notice of the summons is mailed to the taxpayer. Under IRC § 7609(b)(2)(B), the taxpayer must send a copy of the petition to quash to the party summoned and to the IRS within this 20-day timeframe. The court in *Abusch* noted that the petition was neither timely filed nor mailed to the required parties.

taxpayer's petition to quash a summons issued to the taxpayer's bank.[54] The court held that the summons was to aid in the collection of a tax liability, and the taxpayer was therefore not entitled to notice.[55]

In *Xoriant Corp. v. United States*, two corporations petitioned to quash IRS third-party summonses they received as part of the investigation of another corporation.[56] However, because the summons was issued directly to the two corporations, the court dismissed their petition to quash for lack of jurisdiction since "the functional effect of § 7609 is to preclude a summoned party from filing a motion to quash."[57]

Privileges

Taxpayers attempted to invoke various privileges, including Fifth Amendment, attorney-client, or other privileges in response to an IRS summons. For example, in *United States v. Ali*, the IRS summoned an individual taxpayer to produce certain documents and provide testimony.[58] The taxpayer appeared in response but refused to produce any documents or answer any questions, invoking the Fifth Amendment privilege against self-incrimination.[59] The court held that the summons was proper and ordered the taxpayer to comply. While the taxpayer appeared a second time and answered many questions, she declined to answer over 200 questions, again invoking the Fifth Amendment privilege.[60] She also claimed attorney-client privilege for a specific document. The IRS petitioned the court a second time to compel the taxpayer to answer the remaining questions and produce documents.[61] The court found that the taxpayer was not entitled to invoke the Fifth Amendment for certain documents, because these documents fell under the foregone conclusion exception to the Fifth Amendment and because the act of production was not in itself incriminating.[62] The court also held that the taxpayer had waived her Fifth Amendment rights by disclosing them previously.[63] However, the taxpayer was able to invoke Fifth Amendment protections for other documents and the remaining testimony, because the documents and testimony could prove that the taxpayer willfully misrepresented her income.[64] Finally, the court held that the taxpayer successfully invoked the attorney-client privilege for a list of foreign bank accounts she had provided to her attorneys.

In another case involving attorney-client privilege, *United States v. Sanmina Corp. & Subsidiaries*, the IRS issued a summons seeking two memoranda referenced in a footnote in a report prepared by the

54 *Knudsen v. U.S.*, 114 A.F.T.R.2d (RIA) 5848 (E.D.N.Y. 2014).

55 *Id*. Under IRC § 7609(c)(2)(D)(i), the IRS is not required to provide notice to the taxpayer and the taxpayer therefore has no right to quash the summons if the summons is issued to aid in the collection of the taxpayer's liability.

56 *Xoriant Corp. v. U.S.*, 114 A.F.T.R.2d (RIA) 6461 (N.D. Cal. 2014).

57 *Id.*

58 *U.S. v. Ali*, 114 A.F.T.R.2d (RIA) 6524 (D. Md. 2014). *See also U.S. v. Ali*, 113 A.F.T.R.2d (RIA) 1863 (D. Md. 2014) (discussing the taxpayer's first summons enforcement proceeding).

59 *U.S. v. Ali*, 114 A.F.T.R.2d (RIA) 6524 (D. Md. 2014).

60 *Id.*

61 *Id.*

62 *Id*. The court also addressed the taxpayer's request to reconsider its previous ruling that certain documents relating to the taxpayer's foreign bank accounts fell under the required records doctrine, which is another exception to the Fifth Amendment privilege. Essentially, the required records doctrine provides that the Fifth Amendment privilege does not apply to business records that are customarily kept in accordance with government regulation. The court noted that one of the rationales behind the required records doctrine is that the government or a regulatory agency should be able to overcome the assertion of the Fifth Amendment Privilege to inspect the records it requires an individual to keep as a condition of voluntarily participating in that regulated activity. Therefore, the court held that because the taxpayer chose to engage in transactions with foreign banks and entities that have specific statutory reporting requirements, she consented to present these records to the government if asked and could not invoke the Fifth Amendment privilege to avoid doing so.

63 *Id.*

64 *Id.*

taxpayer's attorneys to substantiate a significant deduction.[65] The business taxpayer resisted, claiming the attorney-client and work product privileges protected the memoranda.[66] The court held that the taxpayer sufficiently demonstrated that the memoranda "constituted tax advice from lawyers," therefore the attorney-client privilege attaches. The court also held that the work product privilege applied because the memoranda were prepared in anticipation of litigation. In addition, the court found that the taxpayer did not waive either privilege.[67]

Civil Contempt

A taxpayer who "neglects or refuses to obey" an IRS summons may be held in civil contempt.[68] This year, six taxpayers were held in civil contempt for failing to comply with a court order enforcing an IRS summons.[69] Overall, contempt proceedings accounted for approximately seven percent of all summons-related cases. Unless the taxpayers complied with the court order, they were subject to arrest,[70] fines,[71] or both.[72]

The Impact of *United States v. Clarke*

The Supreme Court's decision in *Clarke* had an immediate impact, as taxpayers sought evidentiary hearings to challenge a summons. First, in *United States v. Ali* (discussed above), the taxpayer argued that the Supreme Court relaxed the standard to obtain an evidentiary hearing, thus changing the law for summons enforcement.[73] However, the district court believed that *Clarke* did not change the law; instead, *Clarke* simply resolved a circuit split.[74]

In *Schwartz v. United States*, the taxpayers alleged that the IRS issued a third-party summons in bad faith; however, the court held that the taxpayers were not entitled to an evidentiary hearing because their allegations did not "rise above conclusory allegations."[75] Similarly, in *Masciantonio v. United States*, the taxpayer also made conclusory assertions that did not "provide a basis for an evidentiary hearing."[76]

In addition to the themes above, one case raised the issue of who may be present at a summons hearing on behalf of the taxpayer. In *United States v. McEligot*, the IRS summoned a taxpayer's accountant in connection with an audit of the taxpayer.[77] The accountant appeared at the hearing but refused to testify unless the taxpayer's attorney was present.[78] The court found that IRC § 7609(b), which gives certain individuals the right to intervene in an enforcement proceeding, does not provide a right to intervene

65 *U.S. v. Sanmina Corp. & Subsidiaries*, 2015 U.S. Dist. LEXIS 66123 (N.D. Cal. 2015), *appeal docketed*, No. 15-16416 (9th Cir. July 15, 2015).

66 *Id.*

67 *Id.*

68 IRC § 7604(b).

69 *See U.S. v. Bowler*, 2015 U.S. Dist. LEXIS 57862 (D. Minn. 2015); *U.S. v. Erickson*, 115 A.F.T.R.2d (RIA) 684 (M.D. Fla. 2015); *U.S. v. Nichols*, 2015 U.S. Dist. LEXIS 59444 (E.D. Mich. 2015); *U.S. v. Snow*, 115 A.F.T.R.2d (RIA) 1002 (E.D. Tenn. 2015); *U.S. v. Thornton*, 115 A.F.T.R.2d (RIA) 1258 (D. Minn. 2015), *appeal docketed*, No. 15-1774 (8th Cir. Apr. 15, 2015); *U.S. v. Vanderpool*, 114 A.F.T.R.2d (RIA) 6968 (W.D. Mo. 2014).

70 *U.S. v. Bowler*, 2015 U.S. Dist. LEXIS 57862 (D. Minn. 2015).

71 *U.S. v. Erickson*, 115 A.F.T.R.2d (RIA) 684 (M.D. Fla. 2015).

72 *U.S. v. Thornton*, 115 A.F.T.R.2d (RIA) 1258 (D. Minn. 2015), *appeal docketed*, No. 15-1774 (8th Cir. Apr. 15, 2015).

73 *U.S. v. Ali*, 114 A.F.T.R.2d (RIA) 6524 (D. Md. 2014).

74 *Id.* The 11th Circuit had held that "a bare allegation of improper motive is sufficient," contrary to other circuits.

75 *Schwartz v. U.S.*, 115 A.F.T.R.2d (RIA) 1942 (S.D. Fla. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1939 (S.D. Fla. 2015).

76 *Masciantonio v. U.S.*, 114 A.F.T.R.2d (RIA) 7010 (W.D. Pa. 2014), *appeal docketed*, No. 15-1072 (3d Cir. Jan. 9, 2015).

77 *U.S. v. McEligot*, 115 A.F.T.R.2d (RIA) 1433 (N.D. Cal. 2015), *appeal docketed*, Nos. 15-16128 and 15-16134 (9th Cir. 2015).

78 *Id.*

in a summons hearing.[79] The court held that "a taxpayer does not have an absolute right to be present at a third-party summons hearing concerning the taxpayer's liabilities."[80] The proper test is "the usual process of balancing opposing equities" between the government's interest in obtaining information in a non-adversarial manner and the taxpayer's interest in preventing improper disclosure of records.[81] Under this test, the court found that the equities were in favor of the government because no attorney-client or work product privileges were implicated, and the accountant could raise the tax practitioner privilege if necessary.[82]

CONCLUSION

The IRS may issue a summons to obtain information to determine whether a tax return is correct or if a return should have been filed to ascertain a taxpayer's tax liability or to collect a liability.[83] Accordingly, the IRS may request documents and testimony from taxpayers who have failed to provide that information voluntarily.

While the number of summons enforcement cases has decreased since 2012, summons enforcement continues to be a significant source of litigation.[84] The IRS also continues to be successful in the vast majority of summons enforcement litigation. Taxpayers and third parties rarely succeed in contesting IRS summonses due to the significant burden of proof and strict procedural requirements. In addition, the IRS's temporary regulations allowing the use of outside parties to assist in examinations and participate in summons interviews have generated controversy and litigation.[85] Depending on the outcome of this litigation, there may be additional cases on this issue in future years.

79 *U.S. v. McEligot*, 115 A.F.T.R.2d (RIA) 1433 (N.D. Cal. 2015), *appeal docketed*, Nos. 15-16128 and 15-16134 (9th Cir. 2015).

80 *Id*.

81 *Id*.

82 *Id*.

83 IRC § 7602(a).

84 In the summons enforcement Most Litigated Issue section of the 2014 Annual Report to Congress, we noted that the IRS's Large Business and International Division (LB&I) issued guidance to examiners in November 2013 on how to handle cases where the taxpayer does not provide a complete response to an Information Document Request (IDR) by the response date. This guidance required the examiner to issue a delinquency notice and then a pre-summons letter prior to issuing a summons. LB&I created these new procedures, that focus on enhanced pre-summons communications, because it believed the new process will improve the IRS's "ability to gather information timely and reduce the need to enforce IDRs through summonses." We remarked that "if effective, these new procedures could reduce the number of summonses issued, and as a consequence, we may see less litigation in this area in the future." It is possible that LB&I's guidance and procedures have contributed to this year's significant decline in summons enforcement cases.

85 *See supra* note 41. There is notable current summons enforcement litigation involving the IRS's use of an outside law firm in an audit of Microsoft Corporation's transfer pricing arrangements. *See* Dolores W. Gregory, *Transfer Pricing: Microsoft Pushes for Evidentiary Hearing, Cites IRS's 'Illegal' Deal With Quinn Emanuel*, Tax Notes Today (Apr. 27, 2015). Although it is outside of the reporting period for the Most Litigated Issues section, Microsoft was successful in obtaining an evidentiary hearing in the summons enforcement case. *See U.S. v. Microsoft Corp.*, 2015 WL 4496749 (W.D. Wash. 2015). Commentators have come out both for and against the IRS's use of outside attorneys in cases such as Microsoft's. *Cf.* Roger A. Pies, *IRS Prerogative to Hire Outside Counsel*, Tax Notes Today (July 7, 2015) (arguing that the IRS should be allowed to retain outside counsel in a big document case) and Stuart Gibson, *If the IRS needs Good Lawyers, it Should Look Across the Street*, Tax Notes Today (Mar. 30, 2015) (questioning why the IRS did not seek assistance from the DOJ in the Microsoft case).

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

SUMMARY

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.[1] 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 Internal Revenue Code (IRC) § 61 such as wages,[2] interest,[3] dividends,[4] and annuities.[5]

TAXPAYER RIGHTS IMPACTED[6]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

PRESENT LAW

IRC § 61 broadly defines gross income as "all income from whatever source derived."[7] The U.S. Supreme Court has defined gross income as any accession to wealth.[8] Over time, however, Congress has carved out numerous exceptions and exclusions from this broad definition of gross income and has based other elements of tax law on the definition.[9]

The Commissioner may identify particular items of unreported income or reconstruct a taxpayer's gross income using methods such as the bank deposits method.[10] If the Commissioner determines a tax deficiency, the IRS issues a Statutory Notice of Deficiency.[11] If the taxpayer challenges the deficiency, the Commissioner's notice is entitled to a presumption of correctness; the taxpayer generally bears the burden of proving that the determination is erroneous or inaccurate.[12]

1 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 472-76; National Taxpayer Advocate 2013 Annual Report to Congress 355-61.

2 IRC § 61(a)(1). *See, e.g.*, *Nix v. Comm'r*, 580 F. App'x 887 (11th Cir. 2014).

3 IRC § 61(a)(4). *See, e.g.*, *Shi v. Comm'r*, T.C. Memo. 2014-173.

4 IRC § 61(a)(7). *See, e.g.*, *Ebert v. Comm'r*, T.C. Memo. 2015-5.

5 IRC § 61(a)(9). *See, e.g.*, *Robertson v. Comm'r*, T.C. Memo. 2014-143.

6 *See* Taxpayer Bill of Rights, *available at* www.Taxpayer.Advocate.irs.gov/taxpayer-rights.

7 IRC § 61(a).

8 *Comm'r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955) (interpreting § 22 of the Internal Revenue Code of 1939, the predecessor to IRC § 61).

9 *See, e.g.*, IRC § 104 (compensation for injuries or sickness); IRC § 105 (amounts received under accident and health plans); IRC § 108 (income from discharge of indebtedness); IRC § 6501(limits on assessment and collection, determination of "substantial omission" from gross income).

10 IRC § 6001. *See, e.g.*, *DiLeo v. Comm'r*, 96 T.C. 858, 867 (1991).

11 IRC § 6212. *See also* Internal Revenue Manual (IRM) 4.8.9.2, *Notice of Deficiency Definition* (July 9, 2013).

12 *See* IRC § 7491(a) (burden shifts only where the taxpayer produces credible evidence contradicting the Commissioner's determination and satisfies other requirements). *See also Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted).

ANALYSIS OF LITIGATED CASES

In the 80 opinions involving gross income issued by the federal courts and reviewed for this report, gross income issues most often fall into two categories: (1) what is included in gross income under IRC § 61 and (2) what can be excluded under other statutory provisions. A detailed list of the cases appears in Table 4 of Appendix 3.

In 27 cases (34 percent), taxpayers were represented, while the rest were *pro se* (without counsel).[13] Ten of the 27 cases where taxpayers had representation (about 37 percent) prevailed in full or in part in their cases, whereas *pro se* taxpayers prevailed in full or in part in seven cases. Overall, taxpayers prevailed in full or in part in 17 of 80 cases (about 21 percent).

Drawing on the full list in Table 4 of Appendix 3, we have chosen to discuss cases involving damage awards and IRA distributions. In addition, we discuss a case of first impression involving the characterization of refundable state tax credits.

Damage Awards

Taxation of damage awards continues to generate litigation. This year, taxpayers in at least four cases (five percent of those reviewed) challenged the Commissioner's inclusion of damage awards in their gross income, but no taxpayers prevailed in these cases.[14]

IRC § 104(a)(2) specifies that damage awards and settlement proceeds[15] are taxable as gross income unless the award was received "on account of personal physical injuries or physical sickness."[16] Congress added the "physical injuries or physical sickness" requirement in 1996;[17] until then, the word "physical" did not appear in the statute. The legislative history of the 1996 amendments to IRC § 104(a)(2) provides that "[i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness… [but] emotional distress is not considered a physical injury or physical sickness."[18] Thus, damage awards for emotional distress are not considered as received on account of physical injury or physical sickness, even if the emotional distress results in "insomnia, headaches, [or] stomach disorders."[19]

To justify exclusion from income under IRC § 104, the taxpayer must show settlement proceeds are in lieu of damages for physical injury or sickness.[20] One case presented a unique issue regarding the characterization of payments made to a taxpayer for contracting to comply with the process to become an egg donor. In *Perez v. Commissioner*, the taxpayer petitioned the U.S. Tax Court to exclude from her income

13 One case involved three consolidated cases, where one case docket showed the taxpayers were *pro se* while the other two case dockets showed representation. *See Worth v. Comm'r*, T.C. Memo. 2014-232, *appeal docketed*, No. 15-70665 (9th Cir. Mar. 3, 2015). For the purpose of calculating the number and percentage of cases where taxpayers appeared *pro se*, we have included *Worth* in the *pro se* category.

14 *See, e.g.*, *Duffy v. U.S.*, 120 Fed. Cl. 55 (Fed. Cl. 2015), *appeal docketed*, No. 15-5076 (Fed. Cir. Apr. 28, 2015).

15 *See* Treas. Reg. § 1.104-1(c) (damages received, for purposes of IRC § 104(a)(2), means amounts received "through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of such prosecution").

16 IRC § 104(a)(2).

17 Pub. L. No. 104-188, § 1605(a), 110 Stat. 1755, 1838 (1996).

18 H.R. Rep. No. 104-586, at 143-44 (1996) (Conf. Rep.).

19 H.R. Rep. No. 104-737, at 301 (1996) (Conf. Rep.). Note, however, that IRC § 104(a)(2) excludes from income damages, up to the cost of medical treatment for which a deduction under IRC § 213 was allowed for any prior taxable year, for mental or emotional distress causing physical injury.

20 *See, e.g.*, *Green v. Comm'r*, 507 F.3d 857 (5th Cir. 2007), *aff'g* T.C. Memo. 2005-250.

payments received as compensation for the pain and suffering associated with donating her eggs to a fertility clinic under the theory that the payments should be construed as damages.[21]

Ms. Perez entered contracts with the fertility clinic and the intended recipients of her donor eggs. The contracts detail that the payments are compensation for Ms. Perez's time, effort, pain, and suffering and in no way are the payments for her eggs or for the sale of body parts. Ms. Perez would be paid regardless of the outcome of the egg retrieval; that is, payment was not contingent on her producing usable eggs or on the intended recipients conceiving a viable pregnancy. Although the fertility clinic issued a Form 1099 to Ms. Perez for the payments she received, Ms. Perez, after conferring with other donors on the internet, did not report the payments on her tax return under the theory that the payments were not taxable since they compensated her only for pain and suffering.[22]

The court looked to the question of whether Ms. Perez was compensated for services rendered or for the sale of property.[23] The contract agreement characterized the payments as compensation for her compliance with the egg donor procedure.[24] The Tax Court found the payments to be for services rendered and then looked to the question of whether the payments may be excluded as damages. The court looked at Ms. Perez's challenge to the validity of the Secretary of Treasury's interpretation of "damages" in the regulations.[25] In applying the framework set forth in *Chevron*, the court determined the regulation is a reasonable interpretation and therefore valid.[26] The court then concluded that Ms. Perez voluntarily contracted to undergo the prospective pain and suffering and was compensated for the risk, rendering the compensation not damages.[27]

As illustrated by continuing litigation of the characterization of settlement damages, the question of when damage awards can be excluded from gross income continues to confuse taxpayers. Although we did not identify any cases this year involving mental illness, the National Taxpayer Advocate remains concerned that taxpayers continue to disagree with the IRS's and courts' interpretation that mental illness equates to emotional distress as opposed to physical sickness or injury. In the same way that a physical injury or sickness may have emotional side effects, many mental illnesses manifest themselves as physical symptoms. For instance, many people who have severe depression experience the following physical symptoms: stomachaches, indigestion, constant headaches, tightness in the chest, difficulty breathing, and fatigue.[28] Physical symptoms occur in other mental disorders, such as Post-Traumatic Stress Disorder (PTSD), which affects people who have experienced a traumatic event, such as mugging, rape, torture, being kidnapped or held captive, child abuse, car accidents, train wrecks, plane crashes, bombings, natural or human-caused disasters, or military combat.[29] Current research shows that the experience of trauma can cause neurochemical changes in the brain that create a vulnerability to hypertension and atherosclerotic

21 144 T.C. 51 (2015).

22 *Id*.

23 *Id.*

24 *Id.*

25 *See* Treas. Reg. § 1.104-1(c) (damages received, for purposes of IRC § 104(a)(2), means amounts received "through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of such prosecution").

26 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984) (agency regulations are entitled to deference unless they (1) contradict an unambiguous statute or (2) adopt an unreasonable construction of it).

27 *Perez v. Comm'r*, 144 T.C. 51 (2015).

28 National Institute of Mental Health, *Signs and Symptoms of Depression*, *available at* http://www.nimh.nih.gov/health/topics/depression/men-and-depression/signs-and-symptoms-of-depression/persistent-physical-symptoms.shtml (last visited Oct. 6, 2015).

29 National Institute of Mental Health, *Post-Traumatic Stress Disorder*, *available at* http://www.nimh.nih.gov/health/topics/post-traumatic-stress-disorder-ptsd/index.shtml#part_145373 (last visited Oct. 6, 2015).

heart disease, abnormalities in thyroid and other hormone functions, and increased susceptibility to infections and immunologic disorders that are associated with PTSD.[30] As discussed in the 2009 Annual Report to Congress, the interpretation that mental illness equates to emotional distress seems particularly outdated when considering the medical communities' advancements in understanding the physical cause and symptoms of mental illness.[31]

Individual Retirement Accounts Distributions

IRC § 61(a) defines gross income as "all income from whatever source derived, including (but not limited to)… (9) Annuities; … and (11) Pensions."[32] IRC § 408(d)(1) governs the tax treatment of distributions from individual retirement accounts (IRAs) and provides that they are generally included in gross income as amounts received as an annuity under IRC § 72.

Taxpayers in at least ten cases argued that portions of their IRA distributions, pensions, or retirement accounts were excluded from gross income, prevailing, in part, in one case.[33] Taxpayers in at least two cases challenged the taxability of the distributions, arguing the "rollover provision" under IRC § 408(d) applied.[34] The "rollover provision" generally excludes from gross income IRA distributions that are transferred into an eligible retirement account within 60 days of receipt.[35] Taxpayers are limited, however, under IRC § 408(d)(3)(B) to one nontaxable rollover per year.[36]

For example, in *Bohner v. Commissioner*, the taxpayer initiated two withdrawals from his IRA and characterized the withdrawals as a rollover to repay a loan he took from a friend and his own funds earlier that year to pay an extra amount to the Office of Personnel Management to boost his federal retirement pay.[37] The court found the distributions includible in gross income. The federal retirement system is not required to accept tax-free rollovers as a form of deposit, and even if it did, the court found that the taxpayer did not make the retirement plan aware of his attempt to complete a rollover and, therefore, the plan would not have been able to determine the proper tax treatment of the contribution.[38]

Refundable State Tax Credits

The Tax Court decided a case of first impression regarding the characterization and taxability of targeted New York State tax credits. In *Maines v. Commissioner*, the taxpayers (husband and wife) petitioned for

30 *See* U.S. Department of Veterans Affairs, National Center for PTSD, *available at* http://www.ptsd.va.gov/professional/co-occurring/ptsd-physical-health.asp (last visited Oct. 6, 2015).

31 National Taxpayer Advocate 2009 Annual Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*). The National Taxpayer Advocate recommended that Congress amend IRC § 104(a)(2) to exclude from gross income payments received as settlement for mental anguish, emotional distress, and pain and suffering. Such change was recommended because mental anguish, emotional distress, and pain and suffering can be caused by a physical condition in the body and can cause physical symptoms. Over the past few years, doctors and researchers have made significant advances in identifying changes that occur in the brain when a person is plagued with mental illness.

32 IRC § 61(a).

33 *See Morles v. Comm'r*, T.C. Summ. Op. 2015-13 (portion of IRA distribution allocable to income was included in gross income; portion allocable to the taxpayer's investment in the contract was not included in gross income).

34 *See Bohner v. Comm'r*, 143 T.C. 224 (2014); *Dabney v. Comm'r*, T.C. Memo. 2014-108.

35 IRC § 408(d)(3)(A)(i), (ii); *Schoof v. Comm'r*, 110 T.C. 1, 7 (1998).

36 IRC § 408(d)(3)(B).

37 143 T.C. 224 (2014).

38 *Id*. at 230.

redetermination of income tax deficiencies arising from receipt of refundable tax credits passed through their S Corporation and Limited Liability Company.[39]

New York state offers certain refundable state tax credits to businesses that either expand or enter into business in targeted impoverished areas and maintain the business in those areas with a required number of employees. The business must meet all requirements to be eligible for the credits. New York characterizes the credits as refunds of overpayments of state income tax, the same position the taxpayers maintained, with the result that the payments should not be included in gross income.[40] In contrast, the Commissioner asserted the credits were taxable income.[41] The court determined that the label for the credits by New York is not binding on the federal government for federal taxation purposes.

Three different credits were at issue in *Maines*. Each has distinct qualifications, and the court determined that the credits fall into two categories. Two credits were not tied to state taxes previously paid to New York and were, therefore, subsidies to the business and as such were fully includible in the taxpayers' gross income.[42] The third credit was partially refundable to the taxpayers above the amount of the credit used to reduce the taxpayers' property tax liability. As a result, the taxpayers were required to include in gross income the amount of the credit refunded above their property tax liability.[43] The court's decision will impact a number of other New York residents who were similarly challenging the tax treatment of these credits.[44]

CONCLUSION

Taxpayers litigate many of the same gross income issues every year due to the complex nature of what constitutes gross income. As the definition is very broad and the courts broadly interpret accession to wealth as gross income, most cases were decided in favor of the IRS and courts continued to narrowly interpret exclusions from gross income.

While the number of cases involving the tax treatment of settlements and awards continued to decrease, from five in 2014 to four this year, it remains a perennial area of confusion for taxpayers. The National Taxpayer Advocate has previously recommended a legislative change that would clarify the tax treatment of court awards and settlements by permitting taxpayers to exclude any payments received as a settlement or judgment for mental anguish, emotional distress, or pain and suffering.[45]

Cases involving the tax treatment of distributions from IRAs and pensions made up a larger percentage of overall cases this year, with almost 13 percent of cases compared to about 11 percent in 2014. Taxpayers litigated this issue with only minor success this year, prevailing, in part, in only one case.

39 144 T.C. No. 8 (2015).

40 State tax refunds are not income unless a taxpayer claimed a deduction for them by itemizing for the previous year. *See* IRC § 111.

41 *Maines v. Comm'r*, 144 T.C. No. 8 (2015).

42 *Id*.

43 *Id*.

44 *Id*. at n. 5 (acknowledging that there were 11 related but unconsolidated cases pending before the Tax Court that were filed by New York residents involving this issue).

45 National Taxpayer Advocate Annual 2009 Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*).

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

SUMMARY

The IRS Restructuring and Reform Act of 1998 (RRA 98)[1] created Collection Due Process (CDP) hearings to provide taxpayers with an independent review by the IRS Office of Appeals of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first 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.[2]

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court.[3] Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.[4]

Since 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.[5] 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*[6] and nine were represented.

The cases discussed below 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.[7] In particular, by providing an opportunity for a taxpayer to challenge the underlying liability and raise alternatives to the collection action, the CDP hearing enables the taxpayer's *right to challenge the IRS position and be heard*. If the taxpayer does

1 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 Internal Revenue Code (IRC) §§ 6320(c) (lien) and 6330(c) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test.

3 IRC § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

4 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax.). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review upon a showing of "good cause," if the underlying tax liability is not at issue.

5 For a list of all cases reviewed, see Table 5 in Appendix 3, *infra*.

6 *Pro se* means "[f]or oneself; on one's own behalf; without a lawyer." Black's Law Dictionary (10th ed. 2014), *available at* http://westlaw.com.

7 IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights. *See also* National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

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*.

TAXPAYER RIGHTS IMPACTED[8]

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

PRESENT LAW

Current law provides taxpayers an opportunity for independent review of an NFTL filed by the IRS or of a proposed levy action.[9] As discussed above, the purpose of CDP rights is to give taxpayers adequate notice of IRS collection activity and a meaningful hearing before the IRS deprives them of property.[10] The hearing allows taxpayers to raise issues relating to collection of the liability, including:

- The appropriateness of collection actions;[11]
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;[12]
- Appropriate spousal defenses;[13]
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a statutory notice of deficiency or have another opportunity to dispute the liability;[14] and
- Any other relevant issue relating to the unpaid tax, the NFTL, or proposed levy.[15]

A taxpayer cannot raise an issue considered at a prior administrative or judicial hearing if the taxpayer participated meaningfully in that hearing or proceeding.[16]

8 *See* Taxpayer Bill of Rights, *available at* www.Taxpayer.Advocate.irs.gov/taxpayer-rights.

9 IRC §§ 6320 and 6330. *See* RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

10 Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. *See U.S. v. Nat'l Bank of Commerce*, 472 U.S. 713, 726-31 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

11 IRC § 6330(c)(2)(A)(ii).

12 IRC § 6330(c)(2)(A)(iii).

13 IRC § 6330(c)(2)(A)(i).

14 IRC § 6330(c)(2)(B).

15 IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

16 IRC § 6330(c)(4).

Procedural Collection Due Process Requirements

The IRS must provide a CDP notice to the taxpayer after filing the first NFTL or generally before its first intended levy for the particular tax and tax period.[17] The IRS must provide the notice not more than five business days after the day of filing the NFTL, or at least 30 days before the day of the proposed levy.[18]

If the IRS files a lien, the CDP lien notice must inform the taxpayer of the right to request a CDP hearing within a 30-day period, which begins on the day after the end of the five-business day period after the filing of the NFTL.[19] In the case of a proposed levy, the CDP levy notice must inform the taxpayer of the right to request a hearing within the 30-day period beginning on the day after the date of the CDP notice.[20]

Requesting a CDP Hearing

Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing within the applicable period.[21] The Code and regulations require taxpayers to provide their reasons for requesting a hearing. Failure to provide the basis may result in denial of a face-to-face hearing.[22] Taxpayers who fail to timely request a CDP hearing will be afforded an "equivalent hearing," which is similar to a CDP hearing but lacks judicial review.[23] Taxpayers must request an equivalent hearing within the one-year period beginning the day after the five-business day period following the filing of the NFTL, or in levy cases, within the one-year period beginning the day after the date of the CDP notice.[24]

Conduct of a CDP Hearing

The IRS generally will suspend levy action throughout a CDP hearing involving a notice of intent to levy. However, the requirement to suspend levy action is inapplicable in certain circumstances where the IRS is not required to provide a CDP hearing prior to the levy and is only required to provide the CDP hearing within a reasonable time after the levy.[25] These circumstances occur when the IRS determines that:

- The collection of tax is in jeopardy;

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17 IRC § 6330(f) permits the IRS to levy without first giving a taxpayer a CDP notice in the following situations: the collection of tax is in jeopardy, a levy was served on a state to collect a state tax refund, the levy is a disqualified employment tax levy, or the levy was served on a federal contractor. A disqualified employment tax levy is any levy to collect employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h).

18 IRC § 6320(a)(2) or § 6330(a)(2). The CDP notice can be provided to the taxpayer in person, left at the taxpayer's dwelling or usual place of business, or sent by certified or registered mail (return receipt requested) to the taxpayer's last known address.

19 IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

20 *Id*.

21 IRC §§ 6330(a)(3)(B) and 6320(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2) A-C1(ii) and 301.6330-1(c)(2) A-C1(ii).

22 IRC §§ 6320(b)(1) and 6330(b)(1); Treas. Reg. §§ 301.6320-1(c)(2) A-C1, 301.6330-1(c)(2) A-C1, 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8. The regulations require the IRS to provide the taxpayer an opportunity to "cure" any defect in a timely filed hearing request, including providing a reason for the hearing. Form 12153 includes space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider, as well as examples of common reasons for requesting a hearing. *See* IRS Form 12153, *Requests for Collection Due Process or Equivalent Hearing* (Mar. 2011).

23 Treas. Reg. §§ 301.6320-1(i)(2) Q&A-I6 and 301.6330-1(i)(2) Q&A-I6; *Business Integration Servs., Inc. v. Comm'r*, T.C. Memo. 2012-342 at 6-7; *Moorhous v. Comm'r*, 116 T.C. 263 (2001). A taxpayer can request an Equivalent Hearing by checking a box on Form 12153, *Request for Collection Due Process or Equivalent Hearing*, by making a written request or by confirming that he or she wants the untimely CDP hearing request to be treated as an Equivalent Hearing when notified by Collection of an untimely CDP hearing request. Internal Revenue Manual (IRM) 5.19.8.4.3, *Equivalent Hearing (EH) Requests and timeliness of EH Requests* (Nov.1, 2007).

24 Treas. Reg. §§ 301.6320-1(i)(2) A-I7 and 301.6330-1(i)(2) A-I7.

25 *See, e.g.*, *Dorn v. Comm'r*, 119 T.C. 356 (2002); *Zapara v. Comm'r*, 124 T.C. 223 (2005); *Bibby v. Comm'r*, T.C. Memo. 2013-281.

- The collection resulted from a levy on a state tax refund;
- The IRS has served a disqualified employment tax levy; or
- The IRS has served a federal contractor levy.[26]

The IRS also suspends levy action throughout any judicial review of Appeals' determination, unless the IRS obtains an order from the court permitting levy on the grounds that the underlying tax liability is not at issue, and the IRS can demonstrate good cause to resume collection activity.[27]

CDP hearings are informal. When a taxpayer requests a hearing with respect to both a lien and a proposed levy, Appeals will attempt to conduct one hearing.[28] Courts have determined that a CDP hearing need not be face-to-face but can take place by telephone or correspondence,[29] and Appeals will conduct the hearing by telephone unless the taxpayer requests a face-to-face conference.[30] The CDP regulations state that taxpayers who provide non-frivolous reasons for opposing the IRS collection action will generally be offered but not guaranteed face-to-face conferences.[31] Taxpayers making frivolous arguments are not entitled to face-to-face conferences.[32] A taxpayer will not be granted a face-to-face conference concerning a collection alternative, such as an IA or OIC, unless other taxpayers would be eligible for the alternative under similar circumstances.[33] For example, the IRS will not grant a face-to-face conference to a taxpayer who proposes an OIC as the only issue to be addressed but failed to file all required returns and is therefore ineligible for an offer. Appeals may, however, at its discretion, grant a face-to-face conference to explain the eligibility requirements for a collection alternative.[34]

The CDP hearing is to be held by an impartial officer from Appeals, who is barred from engaging in *ex parte* communication with IRS employees about the substance of the case and who has had "no prior

26 IRC § 6330(e)(1) provides the general rule for suspending collection activity. IRC § 6330(f) provides that if collection of the tax is deemed in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS served a disqualified employment tax levy or a federal contractor levy, IRC § 6330 does not apply, except to provide the opportunity for a CDP hearing within a reasonable time after the levy. *See Clark v. Comm'r*, 125 T.C. 108, 110 (2005) (citing *Dorn v. Comm'r*, 119 T.C. 356 (2002)).

27 IRC § 6330(e)(1) and (e)(2).

28 IRC § 6320(b)(4).

29 *Katz v. Comm'r*, 115 T.C. 329, 337-38 (2000) (finding that telephone conversations between the taxpayer and the Appeals Officer constituted a hearing as provided in IRC § 6320(b)). Treas. Reg. §§ 301.6320-1(d)(2) A-D6, A-D8 and 301.6330-1(d)(2) A-D6, A-D8.

30 *See, e.g.*, *Appeals Letter 4141* (rev. Aug. 2012) (acknowledging the taxpayer's request for a CDP hearing and providing information on the availability of face-to-face conference). The National Taxpayer Advocate has repeatedly raised concerns regarding the inadequacy of Appeals' communication to taxpayers on how to request a face-to-face hearing and where this information is included in the letter. *See* National Taxpayer Advocate 2005 Annual Report to Congress 136 (Most Serious Problem: *Appeals Campus Centralization*); National Taxpayer Advocate 2009 Annual Report to Congress 70 (Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Customer Satisfaction or Confidence in Appeals*); National Taxpayer Advocate 2010 Annual Report to Congress 128 (Most Serious Problem: *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered*). For information regarding the availability of Virtual Service Delivery (VSD) teleconferencing, which provides virtual face-to-face meeting in remote locations, see National Taxpayer Advocate 2012 Annual Report to Congress 462 (Status Update: *The IRS Has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance*). *See also* Director, Policy, Quality and Case Support, *Implementation of Virtual Service Delivery (VSD)*, Memorandum AP-08-0714-0007 (July 24, 2014).

31 Treas. Reg. §§ 301.6320-1(d)(2) (Q&A-D7) and 301.6330-1(d)(2) (Q&A-D7).

32 *Id*.

33 *Id*.

34 *Id*.

involvement."[35] In addition to addressing the issues raised by the taxpayer, the Appeals Officer must verify that the IRS has met the requirements of all applicable laws and administrative procedures.[36] An integral component of the CDP analysis is the balancing test, which requires the IRS Appeals Officer to weigh the issues raised by the taxpayer and determine whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be "no more intrusive than necessary."[37] The balancing test is central to a CDP hearing because it instills a genuine notion of fairness into the process from the perspective of the taxpayer.[38]

Special rules apply to the IRS's handling of hearing requests that raise frivolous issues. IRC § 6330(g) provides that the IRS may disregard any portion of a hearing request based on a position the IRS has identified as frivolous or that reflects a desire to delay or impede the administration of tax laws.[39] Similarly, IRC § 6330(c)(4) provides that a taxpayer cannot raise an issue if it is based on a position identified as frivolous or reflects a desire to delay or impede tax administration.

IRC § 6702(b) allows the IRS to impose a penalty for a specified frivolous submission, including a frivolous CDP hearing request.[40] A request is subject to the penalty if any part of it "(i) is based on a position which the Secretary has identified as frivolous... or (ii) reflects a desire to delay or impede the administration of Federal tax laws."[41] In *Thornberry v. Commissioner*, the Tax Court held that if Appeals determines a request for an administrative hearing is based entirely on a frivolous position under IRC § 6702(b)(2)(A) and issues a notice stating that Appeals will disregard the request, the Tax Court does have jurisdiction to review Appeals' decision if the taxpayer timely petitions for review.[42] The court found

35 IRC §§ 6320(b)(1), 6320(b)(3), 6330(b)(1) and 6330(b)(3). *See also* Rev. Proc. 2012-18, 2012-1 C.B. 455. *See, e.g.*, *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo. 2006-171, *action on dec.*, 2007-2 (Feb. 27, 2007); *Cox v. Comm'r*, 514 F.3d 1119, 1124-28 (10th Cir. 2008), *action on dec.*, 2009-22 (June 1, 2009).

36 IRC § 6330(c)(1); *Hoyle v. Comm'r*, 131 T.C. 197 (2008).

37 IRC § 6330(c)(3)(C); IRM 8.22.4.2.2, *Summary of CDP Process* (Sept. 25, 2014). *See also* H.R. Rep. No. 105-599, at 263 (1998) (Conf. Rep.). For simplicity, we use the term "proposed collection action" referring to both the actions taken and proposed. IRC § 6330 requires the IRS to notify the taxpayer of the right to request a CDP hearing not less than 30 days before issuing the first levy to collect a tax. Pursuant to IRC § 6320, the taxpayer is notified of the right to request a CDP hearing within five business days *after* the first NFTL for a tax period is filed. Thus, Treasury Regulations under IRC § 6320 require a Hearing Office to consider "[w]hether the continued existence of the filed [NFTL] represents a balance between the need for the efficient collection of taxes and the legitimate concern of the taxpayer that any collection action be no more intrusive than necessary." *See* Treas. Reg. § 301.6320–1(e)(3) A-E1(vi). Similarly, a levy action can be taken before a hearing in the following situations: collection of the tax was in jeopardy; levy on a state to collect a federal tax liability from a state tax refund; disqualified employment tax levies; or a federal contractor levy under the Federal Payment Levy Program. *See* IRC § 6330(f); IRM 8.22.4.2.2, *Summary of CDP Process* (Sept. 25, 2014).

38 *See* National Taxpayer Advocate 2014 Annual Report to Congress 185-96 (Most Serious Problem: *Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*). *See also* Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, 63 Tax Law. 227 (2010).

39 IRC § 6330(g). IRC § 6330(g) is effective for submissions made and issues raised after the date on which the IRS first prescribed a list of frivolous positions. Notice 2007-30, 2007-1 C.B. 883, which was published on or about April 2, 2007, provided the first published list of frivolous positions. Notice 2010-33, 2010-17 C.B. 609, contains the current list.

40 The frivolous submission penalty applies to the following submissions: CDP hearing requests under IRC §§ 6320 and 6330, offers in compromise under IRC § 7122, installment agreements under IRC § 6159, and applications for a Taxpayer Assistance Order under IRC § 7811.

41 IRC § 6702(b)(2)(A). Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous hearing request. The taxpayer then has 30 days to withdraw the submission to avoid the penalty. IRC § 6702(b)(3).

42 *See Thornberry v. Comm'r*, 136 T.C. 356, 367 (2011). The Tax Court recently declined to overturn *Thornberry* in *Buczek v. Comm'r*, 143 T.C. No. 16 (2014), which will be discussed in the Analysis of Litigated Cases below.

Appeals' letter disregarding the hearing request was a determination conferring jurisdiction under IRC § 6330(d)(1), because it authorized the IRS to proceed with the disputed collection action.[43]

Judicial Review of CDP Hearing

Within 30 days of Appeals' determination, the taxpayer may petition the Tax Court for judicial review.[44] The court will only consider issues, including challenges to the underlying liability, that were properly raised during the CDP hearing.[45] An issue is not properly raised if the taxpayer fails to request Appeals' consideration of the issue or requests consideration but fails to present any evidence regarding that issue after being given a reasonable opportunity.[46] The Tax Court, however, may remand a case back to Appeals for more fact finding when the taxpayer's factual circumstances have materially changed between the hearing and the trial.[47] When the case is remanded, the court retains jurisdiction.[48] The resulting hearing on remand provides the parties with an opportunity to complete the initial hearing while preserving the taxpayer's right to receive judicial review of the ultimate administrative determination.[49]

Where the validity of the underlying tax liability is properly at issue in the hearing, the court will review the amount of the tax liability on a *de novo*[50] basis.[51] Where the Tax Court is reviewing the appropriateness of the collection action or subsidiary factual and legal findings, the court will review these determinations under an abuse of discretion standard.[52]

Appellate Venue from Decisions of the Tax Court

Generally, the correct venue for appeals from the Tax Court is the D.C. Circuit unless one of the rules specified in IRC § 7482(b)(1) or exceptions specified in IRC §§ 7482(b)(2) or (b)(3) applies. For instance, IRC § 7482(b)(1)(A) provides that in cases where a petitioner other than a corporation seeks redetermination of a tax liability, venue for review by the United States Court of Appeals lies with the Court of Appeals for the circuit based upon the taxpayer's legal residence.[53] Pursuant to IRC § 7482(b)(2), the taxpayer and the IRS may stipulate the venue for an appeal in writing.

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43 *Thornberry v. Comm'r*, 136 T.C. 356, 364 (2011). The Office of Chief Counsel disagrees with the *Thornberry* holding and will continue to file motions to dismiss for lack of jurisdiction if the taxpayer petitions for Tax Court review of a denial, under § 6330(g), of a CDP hearing request that was determined to be based on a frivolous position. *See* Chief Counsel Directives Manual (CCDM) 35.3.23.5.1, *Motion to Dismiss for Lack of Jurisdiction When CDP Hearing Request Denied Under Section 6330(g)* (July 25, 2012).

44 IRC § 6330(d)(1).

45 *Giamelli v. Comm'r*, 129 T.C. 107 (2007).

46 Treas. Reg. §§ 301.6320-1(f)(2) (Q&A-F3), 301.6330-1(f)(2) (Q&A-F3).

47 *Churchill v. Comm'r*, T.C. Memo. 2011-182; *see also* CCN-2013-002 (Nov. 30, 2012), which provides Counsel attorneys with instructions on when a remand based on changed circumstances might be appropriate.

48 *See, e.g.*, *Pomeroy v. Comm'r*, T.C. Memo 2013-26 at 20.

49 *Wadleigh v. Comm'r*, 134 T.C. 280, 299 (2010).

50 *De novo* means "anew." Black's Law Dictionary (10th ed. 2014), *available at* http://westlaw.com.

51 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. Rep. No. 1059-99, at 266 (Conf. Rep.).

52 *See, e.g.*, *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006); *Dalton v. Comm'r*, 682 F.3d 149 (1st Cir. 2012).

53 IRC § 7482(b)(1) also provides that the proper venue lies with the court of appeals for the circuit in which is located: in the case of a corporation seeking redetermination of tax liability, the principal place of business or principal office or agency of the corporation, or if it has no principal place of business or principal office or agency in any judicial circuit, then the office to which was made the return of the tax in respect of which the liability arises; in the case of a person seeking a declaratory decision under IRC § 7476, the principal place of business or principal office or agency of the employer; in the case of an organization seeking a declaratory decision under IRC § 7428, the principal office or agency of the organization; in the case of a petition under IRC §§ 6226, 6228(a), 6247, or 6252, the principal place of business of the partnership; and in the case of a petition under section IRC § 6234(c), (i) the legal residence of the petitioner if the petitioner is not a corporation, and (ii) the place or office applicable under subparagraph (B) if the petitioner is a corporation.

It has been the longstanding practice of taxpayers and the IRS to appeal CDP, innocent spouse, and interest abatement cases to the circuit of the petitioner's legal residence, principal place of business, or principal office or agency. The Tax Court has also followed this approach. Under the rule established in *Golsen v. Commissioner*,[54] the Tax Court follows the precedent of the circuit court to which the parties have the right to appeal regardless of whether the taxpayer's tax liability was at issue.

In *Byers v. Commissioner*, the D.C. Circuit held that the D.C. Circuit will not transfer cases in non-liability CDP cases unless both parties stipulate to the transfer.[55] The D.C. Circuit did not answer the question of whether another Court of Appeals could hear an appeal of a non-liability CDP decision without stipulation.[56] The court acknowledged that in some CDP cases involving both challenges to the tax liability and collection issues, the venue presumably would be in the appropriate regional circuit.[57]

The IRS Office of Chief Counsel recently issued a notice that provides litigation guidelines to Chief Counsel attorneys about appellate venue for collection due process, innocent spouse, interest abatement, and other non-deficiency cases in light of the decision in *Byers*.[58] In litigating Tax Court cases, Chief Counsel attorneys are instructed to continue asserting the IRS's longstanding position that, for purposes of the *Golsen* rule, venue generally lies in the circuit of the taxpayer's legal residence, principal place of business, or principal office or agency, regardless of whether the issues in the case involve liability. In CDP cases in which liability is at issue, Chief Counsel attorneys are instructed to argue, in the alternative, that venue lies in the regional circuit, which is consistent with *Byers*. The notice further instructs Chief Counsel attorneys not to object to venue if a taxpayer appeals a non-liability case not enumerated in IRC § 7482(b) to the D.C. Circuit[59] or if a taxpayer appeals a non-liability case to the proper regional circuit.[60] To address the uncertainty and confusion among taxpayers and practitioners that impact *the right to be informed*, the National Taxpayer Advocate recommended that Congress amend IRC § 7482(b)(1)(A) to provide that proper appellate venue for all CDP cases lies with the circuit court of appeals based on the taxpayer's legal residency.[61]

ANALYSIS OF PUBLISHED OPINIONS

We identified and reviewed 79 CDP court opinions, a four percent increase from the 76 published opinions in last year's report. As shown in Figure 3.5.1, we have identified on average about 131 opinions per year since 2001.

From 2003 to 2007, the average number of published opinions was approximately 200. Since 2011, however, the average number of published opinions has dropped to 93. At first glance, this decline may be

54 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

55 *Byers*, 740 F.3d 668 (D.C. Cir. 2014). For a more detailed discussion of the *Byers* case, see National Taxpayer Advocate 2014 Annual Report to Congress 477-94 (Most Litigated Issue: *Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330*).

56 740 F.3d at 677. The court noted that it had "no occasion to decide… whether a taxpayer who is seeking review of a CDP decision on a collection method may file in a court of appeals other than the D.C. Circuit if the parties have not stipulated to venue in another circuit."

57 *Id*. at 676.

58 IRS Office of Chief Counsel, Notice CC-2015-006, *Venue for Appeals from Decisions of the Tax Court* (June 30, 2015).

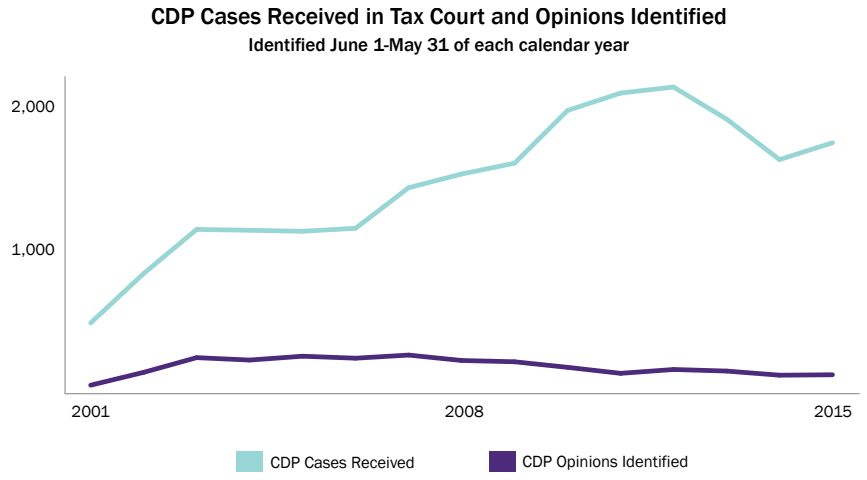
59 *Byers* is controlling in the D.C. Circuit.

60 This is consistent with the IRS Office of Chief Counsel longstanding position.

61 *See* National Taxpayer Advocate 2014 Annual Report to Congress 387-91 (Legislative Recommendation: *Appellate Venue in Non-Liability CDP Cases: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides*).

attributed, in part, to a series of operational changes in fiscal years 2011 and 2012, collectively known as the "Fresh Start" initiative, which led to fewer NFTL filings and more accepted OICs in the past few years, and had a positive impact on many taxpayers and revenue collection.[62] However, it is not clear that the reduction in CDP published opinions is attributable to the reduced number of lien filings. Of the over 21,000 CDP cases petitioned to the Tax Court between June 1, 2000, and May 31, 2015, only 282 were classified as lien cases.[63] Furthermore, the number of CDP cases petitioned has actually increased over time.

FIGURE 3.5.1, CDP Cases Received in Tax Court and Opinions Identified



The increase in CDP cases received suggests that the reduced number of CDP opinions identified may not be the result of fewer taxpayers requesting a CDP hearing and then contesting the CDP determination by filing a Tax Court petition. Instead, it could be the result of more taxpayers deciding not to pursue litigation after filing a petition, more settlements, or more non-precedential CDP orders or bench opinions that do not result in a published opinion.[64] Moreover, the decline in litigated cases may be due to taxpayers litigating many issues of first impression in the years immediately following the enactment of IRC §§ 6320 and 6330, which now have been resolved by the courts.

62 For instance, in fiscal year (FY) 2014, the IRS filed about 49 percent fewer NFTLs than in FY 2011, including a corresponding 58 percent reduction in liens filed by the Automated Collection System. In FY 2011, the IRS filed 1,042,230 liens. *See* IRS, Collection Workload Indicators 5000-23 (Oct. 11, 2011). In FY 2014, the IRS filed 535,580 liens. *See* IRS, Collection Activity Report 5000-25 (Sept. 29, 2014). Additionally, the dollars collected increased from about $17 billion in FY 2011 to about $18.5 billion in FY 2014. *See* IRS, Collection Activity Report 5000-2 (Oct. 3, 2011), IRS, Collection Activity Report 5000-6 (Oct. 3, 2011), IRS, Collection Activity Report 5000-108 (Oct. 5, 2011); IRS, Collection Activity Report 5000-2 (Sept. 29, 2013), IRS, Collection Activity Report 5000-6 (Sept. 30, 2014), IRS, Collection Activity Report 5000-108 (Sept. 29, 2014). We also note that the IRS has accepted 38 percent more offers in compromise than during FY 2011, and that the actual number of accepted offers has almost doubled when compared to FY 2010. Considering FY 2014, the offer acceptance rate of 42 percent is the highest we have seen in many years. *See* IRS, Collection Activity Report 5000-108 (Oct. 5, 2010); IRS, Collection Activity Report 5000-108 (Oct. 5, 2011); IRS, Collection Activity Report 5000-108 (Sept. 29, 2014). During FY 2014, thousands of financially struggling taxpayers have successfully obtained lien withdrawals to help regain their financial viability. *See* IRS, *FY 2014 C-25 Report*.

63 IRS, Chief Counsel Reports, *CDP Cases with Specific UIL Codes Received Between 06/01/2000 To 05/31/2015* (Oct. 7, 2015); IRS, Chief Counsel Reports, *CDP Cases Received Between 06/01/2000 To 05/31/2015* (Oct. 7, 2015). CDP cases received refers to cases where the taxpayer petitioned Tax Court to contest a CDP determination.

64 For a discussion regarding the number of CDP unpublished opinions, see Carlton Smith, *Unpublished CDP Orders Dwarf Post-trial Bench Opinions in Uncounted Tax Court Rulings*, Procedurally Taxing (Jan. 29, 2015), *available at* http://www.procedurallytaxing.com/unpublished-cdp-orders-dwarf-post-trial-bench-opinions-in-uncounted-tax-court-rulings/.

Thus, the 79 published opinions identified this year do not reflect the full number of CDP cases. Table 5 in Appendix 3 provides a detailed list of the published CDP opinions, including specific information about the issues, the types of taxpayers involved, and the outcomes of the cases.

Litigation Success Rate

Taxpayers prevailed in full in 11 of the 79 published opinions issued during the year ending May 31, 2015 (nearly 14 percent).[65] Taxpayers prevailed, in part, in three other cases (nearly four percent). Of the published opinions in which the courts found for the taxpayer, in whole or in part, the taxpayers appeared *pro se* in five cases and were represented in nine others. The IRS prevailed fully in approximately 82 percent of published opinions reviewed, a decrease from the higher recorded success of 89 percent last year. The 18 percent success rate[66] for the taxpayer is the highest since the inception of CDP hearings and may be an indication that the IRS is not addressing collection alternatives adequately at the administrative hearing.

FIGURE 3.5.2, Success Rates in CDP Opinions Identified[67]

Court Decision	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Decided for IRS	95%	95%	89%	90%	92%	90%	92%	89%	92%	86%	84%	89%	82%
Decided for Taxpayer	1%	3%	8%	8%	5%	8%	4%	10%	3%	7%	8%	7%	14%
Split Decision	4%	2%	3%	2%	3%	2%	4%	2%	3%	6%	9%	4%	4%
Neither	n/a	n/a	n/a	n/a	<1%	n/a	n/a	n/a	1%	<1%	n/a	n/a	n/a

Issues Litigated

The cases discussed below are those the National Taxpayer Advocate considers significant or noteworthy. Their outcomes can provide important information to Congress, the IRS, and taxpayers about the rules and operation of CDP hearings. Equally important, all of the cases offer the IRS an opportunity to improve the CDP process and collection practices in both application and execution.

Buczek v. Commissioner

In *Buczek v. Commissioner*, the IRS sent the taxpayer a final notice of intent to levy for unpaid taxes for tax year (TY) 2009.[68] The taxpayer timely requested a CDP hearing with an additional seven pages attached to the request. Each additional page contained phrases such as "Pursuant to UCC 3-501," "Refused from the cause," "Consent not given," and "Permission DENIED." The taxpayer did not

65 *Budish v. Comm'r*, T.C. Memo. 2014-239; *Crosswhite v. Comm'r*, T.C. Memo. 2014-179; *Duarte v. Comm'r*, T.C. Memo. 2014-176; *Gurule v. Comm'r*, T.C. Memo. 2015-61; *Knudsen v. Comm'r*, T.C. Memo. 2015-69; *Lee v. Comm'r*, 144 T.C. 40 (2015); *Reinhart v. Comm'r*, T.C. Memo. 2014-218; *Yuska v. Comm'r*, T.C. Memo. 2015-77; *Ding v. Comm'r*, T.C. Memo. 2015-20; *Sanfilippo, Estate of v. Comm'r*, T.C. Memo. 2015-15; *Synergy Envtl., Inc. v. Comm'r*, T.C. Memo. 2014-148.

66 The success rate includes decisions for the taxpayer as well as split decisions.

67 Numbers may not total to 100 percent due to rounding. A "split" decision refers to a case with multiple issues where both the IRS and the taxpayer prevail on one or more substantive issues. A "neither" decision refers to a case where the court's decision was not in favor of either party.

68 *Buczek v. Comm'r*, 143 T.C. 301 (2014).

request a collection alternative, did not assert he could not pay the underlying tax, and did not raise any other issue. The IRS sent a disregard letter stating that the taxpayer's request for a CDP hearing had been disregarded in its entirety due to the taxpayer raising frivolous arguments and that the IRS could proceed with collection.[69] The taxpayer then appealed the IRS's determination to the Tax Court.

The main issue was whether the Tax Court had the jurisdiction to review an Appeals determination that a CDP hearing request was frivolous in its entirety and would be disregarded. *Thornberry* held that while IRC § 6330(g) denied judicial review of the portions of CDP hearing requests identified as frivolous under IRC § 6702(b)(2)(A), it did not prohibit judicial review of the determination by the Appeals Office that the hearing request was frivolous in its entirety and that collection action could proceed.[70] The IRS requested the court overturn *Thornberry*, arguing that it undermined IRC § 6330(g), which precludes from judicial review any portion of a CDP request deemed frivolous.

Although the court found that IRC § 6330(g) applied to this case, it distinguished it and upheld *Thornberry*. The judge noted that the taxpayers in *Thornberry* had actually raised proper issues in their request but were still denied a hearing because the IRS deemed their issues frivolous. In contrast, the taxpayer in the present case did not challenge the collection action, offer any collection alternatives, challenge the underlying liability, or raise any spousal defenses.[71] The court concluded that since the taxpayer did not raise any issues that could have been considered in the CDP hearing, there were no issues that were deemed to be excluded from the portions of the request deemed frivolous. Because this resulted in the entire request being treated as if it were never made, the court found it lacked jurisdiction to review the Appeals determination, that collection action would proceed, and thus dismissed the case for lack of jurisdiction.

This opinion has two important ramifications. First, it upheld the *Thornberry* decision, providing an important protection for taxpayers and preventing the IRS from denying CDP hearings by simply labeling hearing requests as entirely frivolous. Second, the court adhered to IRC § 6330(g) by finding that if the taxpayer failed to raise any legitimate issues that could be excluded from the frivolous positions, the court did not have jurisdiction to review the Appeals determination that collection would proceed.[72]

Budish v. Commissioner

In *Budish v. Commissioner*,[73] the IRS issued a notice of intent to levy to the taxpayer, a sculptor who works in cast bronze and sells his artwork through a wholly owned S corporation. The taxpayer timely requested and received a CDP hearing. During the hearing, the taxpayer and Appeals Officer (AO) agreed on the payment amount for an IA that would full-pay the outstanding tax liability, but the AO insisted upon the filing of an NFTL as a condition to the IA, stating that it was in the government's best interest since the taxpayer's tax liability exceeded $200,000. The taxpayer's counsel provided a letter from the taxpayer's supplier substantiating that should the IRS file an NFTL, the taxpayer's longstanding business relationship with the foundry would be drastically altered. The taxpayer also argued that an NFTL would result in the buyers of sculptures not financing him by paying upfront for artwork they might never receive, because it may be encumbered by the tax lien. Finally, the taxpayer argued that the NFTL would

69 *Buczek v. Comm'r*, 143 T.C. 301 (2014) at 4.

70 *Thornberry v. Comm'r*, 136 T.C. 356 (2011).

71 *Buczek v. Comm'r*, 143 T.C. 301 (2014) at 12.

72 For further analysis of *Buczek*, see Howard A. Dawson, *Tax Court Won't Bite at IRS Request to Overturn CDP Opinion*, 2014 TNT 194-14 Tax Notes Today (Oct. 7, 2014). *See also* Stephen Olsen, *Summary Opinions for 10/03/14*, Procedurally Taxing (Oct. 13, 2014), *available at* http://www.procedurallytaxing.com/summary-opinions-for-100314/.

73 *Budish v. Comm'r*, T.C. Memo. 2014-239.

adversely affect his credit rating and, as a result, the taxpayer would be unable to pay the foundry using his credit card. Despite all these arguments, the AO insisted upon the filing of an NFTL as a condition to the IA, and the taxpayer declined to enter into the IA with those terms.

Not being able to secure a collection alternative, the AO then issued to the taxpayer a notice of determination sustaining the proposed levy action. In an attachment to the notice, the AO gave two specific reasons for insisting that a notice of lien be filed, both based on interpretations of the Internal Revenue Manual (IRM):

(1) The liability was over $200,000, so the lien must be filed to protect the government's interest;[74] and

(2) The installment agreement request did not meet streamlined, guaranteed, or in-business trust fund express criteria, so the lien was required to be filed as a condition of the installment agreement.[75]

The court determined that the AO misinterpreted and overstated the directives set forth in the IRM and erroneously concluded that the IRM required the NFTL filing. Importantly, the IRM uses the term "in general", which the court interprets to mean that there may be occasions when a lien does not have to be filed.[76] The court went on to state that IRM 5.12.2.4, relied upon by the AO, lists circumstances in which a lien *determination* must be made; it did not say these circumstances lead to a lien *filing*.[77] Furthermore, the court discussed how the IRM allows for revenue officers to defer filing a lien if it would impede the collection of tax. Thus, the court concluded that the IRM did not require the AO to file a lien.

Regarding the balancing test, the court was not persuaded by the AO's statement that the petitioner "failed to show how withholding the lien filing would be in the best interest of the government and facilitate collection," and found that this language "was, in effect, surplusage or boilerplate, included merely for the sake of completeness."[78] The AO did not explain how she came to her conclusion and did not show that she thoroughly considered the taxpayer's contention that the lien would severely impair his ability to pay off the underlying liability. The court found the AO's determination lacked any analysis of "what might have led [the AO] to conclude that levy action will balance the need for efficient collection of tax with petitioner's concern that it would be unnecessarily intrusive." The court further held that the AO failed to discuss balancing factors and thus did not properly balance the need for the efficient collection of the taxpayer's liability with the legitimate concern of the taxpayer that any collection be no more intrusive than necessary as required by IRC § 6330(c)(3)(C).[79]

By failing to perform proper balancing, the AO abused discretion in sustaining the levy. The court remanded the case to Appeals for a supplemental CDP hearing with directions to perform the balancing of factors before determining the appropriate collection action, including the impact of a proposed collection action (NFTL) on the taxpayer's ability to remain in business and generate sufficient income to not default on the proposed installment agreement; the value of the taxpayer's assets and the amount of cash flow; any

74 *See* IRM 5.12.2.4.1, *Integrated Collection System (ICS) Documentation When Deferring the Filing of an NFTL or Choosing Do Not File* (Oct. 14, 2013). The court assumed that the AO "felt constrained" to file an NFTL by this IRM.

75 The AO cited IRM 5.12.2.4.

76 *Budish*, T.C. Memo. 2014-239 at 18.

77 *See* IRM 5.12.2.4, *Determination Criteria for Do-Not-File or Deferring the NFTL Filing* (Oct. 30, 2009).

78 *Budish*, T.C. Memo. 2014-239 at 21. For a detailed discussion of the importance of specific procedures for performing the CDP Balancing test, see National Taxpayer Advocate 2014 Annual Report to Congress 185-96 (Most Serious Problem: *Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*).

79 *Budish*, T.C. Memo. 2014-239.

reasonable alternatives to the proposed collection action (a bond in lieu of the NFTL) under the circumstances; and the validity and the priority of the lien and whether it will attach to the taxpayer's assets.[80]

Gurule v. Commissioner

Gurule v. Commissioner involved a husband (Mr. Gurule) and wife (Mrs. Gurule) who generated a 2009 tax liability as a result of Mr. Gurule taking distributions from a 401(k) retirement plan, which he intended to use for a down payment on a house after he was relocated for his job.[81] Subsequently, Mr. Gurule lost his job and was not able to buy the new house. Accordingly, the taxpayers moved back to their prior house, but it was foreclosed upon shortly thereafter. In 2013, Mr. Gurule took out three separate loans (in addition to two existing loans) from his 401(k) plan to pay expenses for foreclosure, moving, a security deposit, and the first month's rent on a new residence, in addition to substantial medical expenses for Mrs. Gurule and their son and the cost of their son's funeral in 2013. Mrs. Gurule had a severe neurological condition causing seizures, preventing her from working and requiring expenses for surgery, medication, and doctor visits. The Gurule's son, who suffered a brain injury as a child, had numerous medical problems until he passed away in August 2013.[82]

In 2011, the IRS sent the taxpayers a notice proposing adjustments to their 2009 income tax based on the 401(k) distributions; however, it is unclear whether the taxpayers ever received a statutory notice of deficiency. In response to a Notice of Intent to Levy issued on May 7, 2012, the taxpayers timely requested a CDP hearing, stating that collection would cause a hardship. The taxpayers submitted an OIC to the Settlement Officer (SO), proposing to settle their liability for $950, paid over five months, based on doubt as to collectibility. The Centralized OIC Unit preliminarily rejected the proposed OIC, finding the taxpayers could full pay based upon their net realizable equity and future income. The SO made a separate calculation as to the taxpayers' income and reasonable collection potential (RCP). The SO allowed the expense for the payment of the 401(k) loans shown on Mr. Gurule's pay stub, but allowed only one-half of the expense because she did not realize that Mr. Gurule was paid bi-weekly. Furthermore, the SO did not reduce the taxpayers' net realizable equity by the amount of the third and fourth 401(k) loans, explaining that these could be considered dissipated assets, because the taxpayers chose to take out the loans knowing they owed federal taxes.[83] The SO offered the taxpayers the choice of either increasing their OIC or accepting an installment agreement based on their net monthly income as calculated by the SO and the filing of an NFTL. The SO also determined that the taxpayers did not meet the requirements for currently not collectible status. After rejecting an additional OIC proposal from the taxpayers, the SO issued a notice of determination that did not address their claim of financial hardship.

The Tax Court remanded the case back to the IRS, finding the record from the CDP hearing was insufficient to allow the court to determine: (1) whether the IRS properly mailed a statutory notice of deficiency; (2) whether the SO abused her discretion by upholding the levy despite the economic hardship claim; (3) whether the SO properly calculated their RCP; and (4) whether the SO properly considered the taxpayers' special circumstances before rejecting the OIC.

Regarding the statutory notice of deficiency, the court found there was not a copy in the record and the notice of determination did not state whether the SO had verified the mailing of the notice of deficiency.

80 *Budish*, T.C. Memo. 2014-239.
81 T.C. Memo. 2015-61.
82 *Id*. at 3-4.
83 *Gurule*, T.C. Memo 2015-61 at 4.

The court was especially concerned because the notice of determination stated that the SO had verified each of the other statutory requirements.

Concerning the economic hardship claim, the court cited *Vinatieri v. Commissioner* for the principle that an SO in a CDP hearing cannot proceed with the proposed levy action when a taxpayer establishes that it would create an economic hardship because the levy would then have to be immediately released.[84] Further the court referenced an IRM provision that only allows levies of retirement accounts when the taxpayer's conduct has been flagrant and the taxpayer does not depend on the funds for necessary living expenses.[85] Because the notice of determination did not show that the SO considered the economic hardship claim and the administrative record showed no consideration of the IRM provision above, the court found it could not determine whether the SO abused her discretion.

Regarding the SO's calculation of the taxpayers' RCP, the court stated that the SO may have made a material error by not adjusting the taxpayers' net realizable equity of the retirement plan account after the third loan. The court found the SO's treatment of the loans as dissipated assets was not justified, based on the administrative record, which did not establish that Mr. Gurule took out the additional 401(k) loan with intent to disregard the outstanding tax liability. Furthermore, the court noted that the loans appeared to have been used for necessary living expenses.[86] The court also noted that a remand may be appropriate when a taxpayer has experienced a material change in circumstances between the time of the IRC § 6630 hearing and the trial that affects the RCP calculation. It then noted that the taxpayers' middle son passed away after the notice of determination was issued. That event caused taxpayers to take out an additional loan from the 401(k), which affected their RCP and ability to pay the tax liability, and they were still unable to afford to bury his ashes. Finally, the court found the administrative record suggested that the SO rejected the taxpayers' proposed OIC without giving any consideration to their special circumstances, such as Mrs. Gurule's neurological condition and the loans necessary to pay medical expenses for her and their now deceased son.

Ligman v. Commissioner

In *Ligman v. Commissioner*, the taxpayer timely requested a CDP hearing after receiving a levy notice from the IRS for the unpaid tax liabilities for TY 2008.[87] At the hearing, the taxpayer's representative stated that the taxpayer's only source of income was his Railroad Retirement Board benefits and offered a $25 per month partial payment IA. The AO concluded that the petitioner's disposable monthly income was $946 and counter-offered an IA of $765 per month.[88] After not hearing back from the taxpayer's representative, the AO closed the case and sustained the levy. The taxpayer then appealed the determination to the Tax Court.

The taxpayer argued that the AO abused his discretion by including his retirement benefits while calculating his ability to pay, contending that these benefits were partially levy proof. The IRS agreed that

84 *Gurule*, T.C. Memo 2015-61 at 8 (citing *Vinatieri v. Comm'r*, 133 T.C. 392, 400 (2009)). This principle, which supports a taxpayer's *right to a fair and just tax system*, was incorporated into the IRM as a result of TAS's advocacy efforts. *See* IRM 5.11.1.3.1, Pre-Levy Considerations (Aug. 1, 2014).

85 *Id.* (citing IRM 5.11.6.2 (Dec. 2, 2011)). For a detailed discussion of how the IRS's guidance regarding levies on retirement accounts is inadequate and infringes on taxpayer rights, see Most Serious Problem: *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*, *supra*.

86 *Gurule,* T.C. Memo 2015-61 at 12.

87 *Ligman v. Comm'r*, T.C. Memo. 2015-79.

88 *Id.* at 9.

railroad retirement benefits were partially levy proof under IRC §§ 6334(a)(6) and 6331(h). However, the IRS argued that it is not barred from considering the benefits (in its determination of the taxpayer's income and ability to pay) for purposes of determining availability of a collection alternative.

The court agreed with the IRS's argument, acknowledging that the IRM does not specify whether railroad retirement benefits are included in income calculation.[89] The court stated that the railroad retirement benefits are similar to Social Security benefits, which are specifically included in the IRM's calculation of income, despite being partially levy proof. Thus, including the taxpayer's railroad retirement benefits when calculating his ability to pay was not an abuse of discretion by the AO.[90]

Sanfilippo v. Commissioner

This case involved the payment of estate taxes.[91] Martha E. Sanfilippo died testate and left Garrett Rajkovich (Rajkovich) interests in various properties. On receipt of the interests, Rajkovich's ownership in the Hacienda Shopping Center increased from 65.7 to 75.7 percent. In addition to the interests, the decedent's will forgave Rajkovich's debt of $21,268,186 that he owed to the estate.[92]

In March 2005, the estate filed for an extension to file an estate tax return. The IRS granted the extension, and the estate subsequently sent a completed estate tax return in October 2005. The return valued the gross estate at over $62 million, which included Rajkovich's discharged loan and assets from one of the estate's trusts, and reported an estate tax liability of about $15 million. Over the course of 2006 through 2010, the estate requested six additional extensions of time to pay the estate tax, due to liquidity problems of both the estate and Rajkovich. After all but the last extension was granted, the estate, Rajkovich, and the IRS entered into a three-way security agreement. The agreement gave the IRS a first priority security in an estate property, GMK Oakley (GMK), for as long as the liability was unpaid.[93]

On June 21, 2011, IRS sent the estate a notice of intent to levy and notice of the taxpayer's right to a CDP hearing. The estate timely requested a CDP hearing and indicated that it would like to submit an OIC. Rajkovich and his representative then met with SO Pobre to discuss the case. The taxpayer informed the SO that GMK had interest from a potential buyer and the sale funds would be used to satisfy the estate tax liability.[94] After the hearing, the estate submitted a proposal to compromise the liability for a payment of approximately $5 million, to be paid with the proceeds from the potential GMK sale. SO Pobre decided that the RCP of the estate would go up after the potential sale, so he decided to put the case on hold. He subsequently placed the estate in currently not collectible status, taking into account Rajkovich's obligations, independent of the estate, under the security agreement. Unfortunately, the sale of the property was delayed and SO Pobre transferred out of the Appeals Office shortly thereafter. Before SO Pobre transferred, the two sides agreed to meet again to come up with a "common plan" on how to move forward. SO Pobre was then replaced by SO Owyang.

SO Owyang emailed his team manager, stating that he did not feel comfortable working on an estate case, since he was not well versed in the subject area.[95] Even though the underlying liability was not at issue in

89 IRM 5.15.1 and 5.15.1.11(2)(e). Generally all household income will be used to determine the taxpayer's ability to pay. *See* IRM 5.15.1, *Financial Analysis Handbook*.

90 *Ligman v. Comm'r*, T.C. Memo. 2015-79 at 9.

91 *Sanfilippo v. Comm'r*, T.C. Memo. 2015-15.

92 *Id.* at 3.

93 *Id.* at 5.

94 *Id.* at 9.

95 *Sanfilippo v. Comm'r*, T.C. Memo. 2015-15 at 14.

the CDP hearing and the estate had been examined by the IRS, SO Owyang focused his analysis on the estate's transfer to Rajkovich of the Hacienda Shopping Center interest, valued at under $2 million, and the use of this interest by Rajkovich to obtain an almost $10 million loan. SO Owyang's analysis questioning the valuation of the interest ignored the facts that Rajkovich already held a 65.7 percent majority interest in the property before the estate transferred the additional ten percent interest to him and that the IRS had previously determined the interest's value during examination. SO Owyang closed the case and sustained the levy, citing the taxpayer's failure to provide a collection alternative to satisfy the liability. The estate appealed the case to the Tax Court.

The estate argued that SO Owyang abused his discretion when he sustained the levy. The IRS argued that SO Owyang committed a harmless error regarding analysis of the estate assets and that the estate did not submit a proper OIC.[96] The court disagreed with the IRS's harmless error argument because SO Owyang's miscalculation of Rajkovich's Hacienda Shopping Center interest was instrumental in his decision to sustain the levy. The court also found the estate did in fact propose an OIC, and SO Owyang did not give any consideration to the discussions between Rajkovich and SO Pobre regarding the collection alternative or to the three-way security agreement in place. The court held that the SO abused his discretion and remanded the case to Appeals to consider any collection alternatives proposed by the estate.[97]

Gyorgy v. Commissioner

In *Gyorgy v. Commissioner*,[98] the taxpayer did not file tax returns for 2001 through at least 2007. Relying on information reported on third-party information returns, the IRS prepared substitute for returns (SFRs) for the taxpayer for TYs 2001-2003. From 2004 through 2007, the IRS sent notices of deficiency for all three tax years to the address used on the taxpayer's most recently filed return, which was his address on file.[99] The IRS also sent a Form 2797 "R-U-There" letter to one of many possible addresses for the taxpayer that was reported on third-party information returns. The IRS received no responses to any of its correspondence, other than the postal service returning the letters as undeliverable. The IRS took no further steps to locate the taxpayer or reissue notices. Between the years of 2004 and 2007, the IRS assessed the liabilities for all three tax years in which SFRs had been prepared (2001, 2002, and 2003). Then, in 2009, the IRS moved forward with collection activities by filing an NFTL and sending to the taxpayer's current residence a notice of his right to request a CDP hearing. The taxpayer timely requested a CDP hearing, where he challenged the underlying liability and whether the IRS followed proper procedures. The AO sustained the NFTL, finding the IRS followed legal and administrative procedures during the assessment and collection process and the taxpayer did not challenge the IRS's calculation of his liability.[100] The taxpayer then petitioned the Tax Court.

Noting that the taxpayer did not notify the IRS of address changes and presented no evidence to contest the liabilities, the court found the IRS had mailed the statutory notices of deficiency to the taxpayer's last

96 An error is harmless if it does not cause prejudice or does not affect the ultimate determination in the case. *See, e.g.*, *Estate of Mangiardi v. Comm'r*, T.C. Memo. 2011–24, *aff'd*, 442 Fed. Appx. 526 (11th Cir. 2011).

97 *Sanfilippo v. Comm'r*, T.C. Memo. 2015-15 at 26.

98 779 F.3d 466 (7th Cir. 2015), *aff'g* T.C. Docket No. 19240-11 (Mar. 25, 2013).

99 "When a notice or document is sent to a taxpayer's 'last known address,' it is legally effective even if the taxpayer never receives it." Rev. Proc. 2010-16, I.R.B. 2010-19 (May 10, 2010). This revenue procedure explains the IRS's procedures for determining the last known address.

100 *Gyorgy v. Comm'r*, 779 F.3d 466, 470 (7th Cir. 2015), *aff'g* T.C. Docket No. 19240-11 (Mar. 25, 2013).

known address and sustained the lien for TYs 2002 and 2003.[101] The taxpayer appealed the Tax Court's decision to the Court of Appeals for the 7th Circuit.

Three interesting points of discussion were raised in this case. The first was whether judicial review of a CDP decision was limited to the administrative record. The 7th Circuit observed that the Tax Court looked beyond the record when it considered trial testimony. Instead of determining definitively if judicial review should be restricted to the administrative record, the 7th Circuit declined to rule on this issue because neither party raised it, and considered the administrative record as well as evidence presented at the Tax Court trial.[102]

Second, the 7th Circuit addressed what the proper standard of review is when considering whether the IRS followed proper procedures in assessing the liability. It is well established that a challenge to the underlying tax liability requires a *de novo* review, while the Appeal's Office's determination with regard to the collection action is reviewed under an abuse of discretion standard.[103] This case was unique because a standard had to be chosen to review the taxpayer's challenge to the IRS's mailing procedure, which in turn was a challenge to the IRS's assessment of the underlying liability. The 7th Circuit agreed with the Tax Court in applying an abuse of discretion standard for the mailing issue, since it was an administrative decision unrelated to the amount of the underlying liability.[104] Additionally, the Court found that the taxpayer presented no evidence or arguments to challenge the amount of the liability, further precluding applying a *de novo* standard.

The last significant issue was whether the IRS had used reasonable diligence in finding the taxpayer's correct address.[105] It agreed that the IRS had to take certain steps to determine the taxpayer's last known address. In the present case though, the court found that the taxpayer made that job difficult for the IRS by not filing tax returns for many years, moving frequently, and keeping the IRS "in the dark concerning his whereabouts."[106] It concluded that the IRS properly relied on the address listed on his most recently filed tax return and determined that the Appeals Office properly sustained the NFTL against the taxpayer.

CONCLUSION

CDP hearings provide an invaluable opportunity for taxpayers to meaningfully address the appropriateness of IRS collection actions. Given the important protection that CDP hearings offer, it is unsurprising that CDP remains one of the most frequently litigated issues. The cases discussed this year were important for a variety of reasons. They affirmed an important protection for the taxpayer, elaborated upon the Tax Court's test for abuse of discretion, and addressed procedural issues.

The *Buczek* case may have been the most important this year, in that it supported a taxpayer's *right to appeal an IRS decision in an independent forum*. In *Buczek*, the court reaffirmed its holding in Thornberry that the court has jurisdiction to review whether the Office of Appeals properly determined that the taxpayer's CDP hearing request was entirely frivolous or for purposes of delay and correctly treated as

101 The court vacated the lien notice for TY 2001 because the IRS could not produce a copy of the deficiency notice or other proof that a notice was mailed. *Gyorgy v. Comm'r*, 779 F.3d 466, 471 (7th Cir. 2015), *aff'g* T.C. Docket No. 19240-11 (Mar. 25, 2013).

102 *Gyorgy v. Comm'r*, 779 F.3d 466, 473 (7th Cir. 2015), *aff'g* T.C. Docket No. 19240-11 (Mar. 25, 2013).

103 *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006).

104 *Gyorgy v. Comm'r*, 779 F.3d 466, 472, 480-81 (7th Cir. 2015), *aff'g* T.C. Docket No. 19240-11 (Mar. 25, 2013).

105 *Id*.

106 *Id*.

if never submitted, and to review only legitimate issues properly raised in the hearing request. *Buczek* suggests that courts continue to value the protection provided to taxpayers in *Thornberry*. Although the taxpayers in *Buczek* had presented arguments to delay collection, the court understood that overturning *Thornberry* would have detrimental effects on taxpayers beyond just *Buczek*. If *Thornberry* were reversed, not only would a taxpayer's *right to appeal an IRS decision in an independent forum* be weakened, but such a decision would also compromise a taxpayer's *right to challenge an IRS decision and be heard*. This ruling protects taxpayers from the IRS erroneously labeling a request as frivolous to preclude it from judicial review, thus also upholding a taxpayer's *right to a fair and just tax system*.

Sanfilippo shows that there is value in assigning hearing officers to cases in which they have proper knowledge and expertise of the issues. The decision to keep the SO on the case after he complained of his difficulties resulted in needless administrative and judicial costs. To mitigate these costs in the future, the IRS should place hearing officers on cases where they have substantive expertise of issues being presented at a CDP hearing. Further, they should try to make sure that hearing officers see a case through to its completion.[107] This will reduce confusion and rework that occurs when a new hearing officer takes over a case before it is resolved and fully carry out a taxpayer's *right to challenge the IRS's position and be heard*, as well as the *right to appeal an IRS decision in an independent forum*.

The *Budish* decision provides an important development regarding the CDP balancing test. While the vast majority of cases discussing the balancing test have ruled in favor of the IRS over the years, the IRS often merely stated (without elaboration or proper analysis) in these cases it had performed the balancing test. Prior to *Budish*, there was little scrutiny or indepth review, if any, from most courts regarding Appeals' analysis of factors related to balancing the legitimate concerns of taxpayers regarding the intrusiveness of the proposed collection action with the government's interest to collect. The low number of remands may be largely due to the abuse of discretion judicial standard of review, not because Appeals conducted the balancing test properly or analyzed any balancing factors. Thus, the *Budish* decision is significant in describing balancing test factors Appeals should consider upon remand. Moving away from *pro forma* statements and boilerplate language (without proper analysis) and encouraging hearing officers to fully explain which balancing test factors they considered could go a long way in reducing future litigation. By not giving proper attention to the balancing test, the IRS is missing opportunities to improve compliance, enhance taxpayer trust and confidence, relieve undue burden on taxpayers, and support a taxpayer's *right to privacy*.[108]

Gurule was significant in its reaffirmation of *Vinatieri v. Commissioner*, which found an appeals officer in a CDP hearing cannot proceed with the proposed levy action when a taxpayer establishes that it would create an economic hardship, because the levy would then have to be immediately released.[109] Although TAS has advocated extensively on this issue and worked to incorporate this principle into the official explanation of a taxpayer's *right to a fair and just tax system* in the IRM, both TAS employees and tax practitioners have still seen too many cases where the IRS continues to issue levies on taxpayers it knows are experiencing economic hardship.[110]

107 For more information about the problems with Appeals Officers transferring cases, see Most Serious Problem: *Appeals: The Appeals Judicial Approach and Culture Project is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*, *supra*.

108 *See* National Taxpayer Advocate 2014 Annual Report to Congress 185-96 (Most Serious Problem: Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections).

109 *Gurule*, T.C. Memo 2015-61 at 8 (citing *Vinatieri v. Comm'r*, 133 T.C. 392, 400 (2009)).

110 *See* National Taxpayer Advocate 2013 Annual Report to Congress 84-93 (Most Serious Problem: *Hardship Levies: Four Years After the Tax Court's Holding in Vinatieri V. Commissioner, the IRS Continues to Levy on Taxpayers It Acknowledges Are in Economic Hardship and Then Fails to Release the Levies*).

In sum, the CDP hearing is a powerful tool for the taxpayer. Further education of taxpayers about the importance of a full and complete administrative records as well as assignment of hearing officers who have substantive knowledge of the area of tax law and are familiar with the facts and circumstances of a particular case will only strengthen protections for taxpayers intended by Congress. Clarifying the interpretation of IRC § 6330(g) in accord with the *Thornberry* decision would go a long way in reaffirming important due process protections afforded to taxpayers and further the taxpayer *rights to challenge the IRS position and be heard*, *to appeal an IRS decision in an independent forum*, and *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 Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654

SUMMARY

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 Internal Revenue Code (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.[1]

The phrase "addition to tax" is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. 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.[2] The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions.[3] Taxpayers were unable to avoid a penalty in 59 of the 63 cases.

TAXPAYER RIGHTS IMPACTED[4]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

PRESENT LAW

Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before the due date (including extensions) will be subject to a failure to file penalty of five percent of the tax due (minus any credit the taxpayer is entitled to receive and payments made by the due date) for each month or partial month the return is late. This penalty will accrue up to a maximum of 25 percent, unless the failure is due to reasonable cause and not willful neglect.[5] To establish reasonable cause, the taxpayer must show he or she

1 IRC § 6651(a)(3) imposes an addition to tax for failure to pay a tax liability not shown on a return. However, because only a small number of cases involved this penalty, we did not include it in our analysis.

2 IRC §§ 6651(a)(1), (a)(2).

3 IRC § 6654(e).

4 *See* Taxpayer Bill of Rights *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

5 IRC §§ 6651(a)(1), (b)(1). The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

exercised ordinary business care and prudence but was still unable to file by the due date.[6] The failure to file penalty applies to income, estate, gift, employment, self-employment, and certain excise tax returns.[7]

The failure to pay penalty, IRC § 6651(a)(2), applies to a taxpayer who fails to pay an amount shown as tax on the return. The penalty accrues at a rate of 0.5 percent per month on the unpaid balance for as long as it remains unpaid, up to a maximum of 25 percent of the amount due.[8] When IRS imposes both the failure to file and failure to pay penalties for the same month, it reduces the failure to file penalty by the amount of the failure to pay penalty (0.5 percent for each month).[9]

The failure to pay penalty applies to income, estate, gift, employment, self-employment, and certain excise tax returns.[10] The taxpayer will not be held liable if he or she can establish reasonable cause, *i.e.*, the taxpayer must show he or she has exercised ordinary business care and prudence but was still unable to pay by the due date, or that payment on that date would have caused undue hardship.[11] Courts will consider "all the facts and circumstances of the taxpayer's financial situation" to determine whether the taxpayer exercised ordinary business care and prudence.[12] In addition, "consideration will be given to the nature of the tax which the taxpayer has failed to pay."[13]

IRC § 6654 imposes a penalty on any underpayment of estimated tax by an individual or by certain estates or trusts.[14] The law requires four installments per taxable year, each generally 25 percent of the required annual payment.[15] The required annual payment is generally the lesser of 90 percent of the tax shown on the return for the current taxable year or 100 percent of the tax for the previous taxable year.[16] The IRS will determine the amount of the penalty by applying the underpayment rate, according to IRC § 6621, to the amount of the underpayment for the applicable period.[17]

To avoid the penalty, the taxpayer has the burden of proving that one of the following exceptions applies:

- The tax due (after taking into account any federal income tax withheld) is less than $1,000;[18]
- The preceding taxable year was a full 12 months, the taxpayer had no liability for the preceding taxable year, and the taxpayer was a U.S. citizen or resident throughout the preceding taxable year;[19]

6 Treas. Reg. § 301.6651-1(c)(1).

7 IRC § 6651(a)(1).

8 IRC § 6651(a)(2). Note that if the taxpayer timely files the return (including extensions) but an installment agreement is in place, the penalty will continue accruing at the lower rate of 0.25 percent rather than 0.5 percent of the tax shown. IRC § 6651(h).

9 IRC § 6651(c)(1). When both the failure to file and failure to pay penalties are accruing simultaneously, the failure to file will max out at 22.5 percent and the failure to pay will max out at 2.5 percent, thereby abiding by the 25 percent maximum limitation.

10 IRC § 6651(a)(2).

11 Treas. Reg. § 301.6651-1(c)(1). Even when a taxpayer shows undue hardship, the regulations require him or her to also prove reasonable cause.

12 Treas. Reg. § 301.6651-1(c)(1). See, *e.g.*, *East Wind Indus., Inc. v. U.S.*, 196 F.3d 499, 507 (3d Cir. 1999).

13 Treas. Reg. § 301.6651-1(c)(2).

14 IRC §§ 6654(a), (l).

15 IRC §§ 6654(c)(1), (d)(1)(A).

16 IRC § 6654(d)(1)(B).

17 IRC § 6654(a).

18 IRC § 6654(e)(1).

19 IRC § 6654(e)(2).

- The IRS determines that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience;[20] or
- The taxpayer retired after reaching age 62 or became disabled in the taxable year for which estimated payments were required, or in the taxable year preceding that year, and the underpayment was due to reasonable cause and not willful neglect.[21]

In any court proceeding, the IRS has the burden of producing sufficient evidence that it imposed the failure to file, failure to pay, or estimated tax penalties appropriately.[22]

ANALYSIS OF LITIGATED CASES

We analyzed 63 opinions issued between June 1, 2014, and May 31, 2015, where the failure to file penalty, failure to pay penalty, or estimated tax penalty was in dispute. All but 14 of these cases were litigated in the United States Tax Court. A detailed list appears in Table 6 in Appendix 3. Twenty-three cases involved individual taxpayers and 40 involved businesses (including individuals engaged in self-employment or partnerships). Last year, individual filers outnumbered businesses nearly two to one.

Of the 41 cases in which taxpayers appeared *pro se* (without counsel), taxpayers prevailed in full in one case, and six resulted in split decisions. Of the 22 cases in which taxpayers had representation, taxpayers prevailed in full in three cases, and one was a split decision.

Failure to File Penalty

One recurring basis for taxpayer success in IRC § 6651 litigation is IRS failure to meet its burden of production. For example, in *Crawford v. Commissioner*, the IRS and the taxpayer stipulated that the taxpayer's return was timely filed.[23] Despite this agreed upon stipulated fact, at the time of the trial, the IRS argued that the taxpayer failed to file his return timely. However, the court noted that stipulations are treated as conclusive admissions by the parties.[24] The court went on to note that it can relieve parties of a stipulation that is contrary to the record or if justice requires.[25] The court did not ignore the stipulated fact in this case because it determined that it may have the effect of prejudicing the *pro se* taxpayer. Because the IRS previously stipulated that the taxpayer filed his return timely, the IRS had not met its burden of production regarding the appropriateness of the failure to file penalty. Consequently, the court held that the taxpayer was not liable for the failure to file penalty.

In most of the cases reviewed, taxpayers could not successfully establish that the failures to file were due to reasonable cause. Circumstances suggesting reasonable cause are typically outside the taxpayer's control.[26] Frequent reasonable cause claims included medical illness and reliance on an agent.

20 IRC § 6654(e)(3)(A).

21 IRC § 6654(e)(3)(B).

22 *Higbee v. Comm'r*, 116 T.C. 438, 446 (2001) (applying IRC § 7491(c)). An exception to this rule relieves the IRS of this burden where the taxpayer's petition fails to state a claim for relief from the penalty (and therefore is deemed to concede the penalty). *Funk v. Comm'r*, 123 T.C. 213 (2004).

23 T.C. Memo. 2014-156.

24 *Crawford v. Comm'r*, T.C. Memo. 2014-156 (citing U.S. Tax Court Rules of Practice and Procedure, Rule 91(e), and *Chapman Glen Ltd. v. Comm'r*, 140 T.C. 294, 317 (2013)).

25 U.S. Tax Court Rules of Practice and Procedure (as Amended Through July 6, 2012), Rule 91(e): "Binding Effect: A stipulation shall be treated, to the extent of its terms, as a conclusive admission by the parties to the stipulation, unless otherwise permitted by the Court or agreed upon by those parties. The Court will not permit a party to a stipulation to qualify, change, or contradict a stipulation in whole or in part, except that it may do so where justice requires."

26 *McMahan v. Comm'r*, 114 F.3d 366, 369 (2d Cir. 1997), *aff'g* T.C. Memo.1995–547.

Medical Illness

Depending on the facts and circumstances, a medical illness may establish reasonable cause for failure to file, if the taxpayer can show incapacitation to such a degree that he or she could not file a return on time.[27] When considering whether the severity of the illness suffices to establish reasonable cause, the court will analyze a taxpayer's management of his or her business affairs during the illness.[28]

In *Estate of Stuller v. United States*, the IRS assessed a failure to file penalty for the late filing of the taxpayers' (Mr. and Mrs. Stuller) 2003 individual income tax return.[29] On August 27, 2009, Mrs. Stuller (in her capacity individually as well as the executor of Mr. Stuller's estate) fully paid the assessed failure to file penalty. Mrs. Stuller then timely filed a claim for refund for the failure to file penalty.[30] After Mrs. Stuller did not hear from the IRS within six months from the time the claim for refund was filed, she filed a refund suit claiming that the failure to file penalty should be refunded because the failure was due to reasonable cause.[31]

Mrs. Stuller claimed that she was prevented from filing timely tax returns by her inability to locate documents needed to file the 2003 return (*i.e.*, bank statements). She claimed that this inability was due to her being disorganized as a result of extenuating circumstances. More specifically, in early 2003, Mr. Stuller died in a fire, and Mrs. Stuller was hospitalized with pneumonia for several weeks. Some tax records were lost in the fire while others were deposited in storage in unmarked boxes. Mrs. Stuller testified that she experienced stress, depression, and chronic bronchitis following the fire. The granddaughter they cared for also had health and behavioral problems following the death of Mr. Stuller that required additional care. Further, the death of Mr. Stuller created additional work for Mrs. Stuller as trustee.

However, the court pointed out that Mrs. Stuller's 2002 tax return was timely filed in the year of the fire. She actively ran a restaurant business during 2003, firing one director of operations and hiring another. The new director testified that Mrs. Stuller was attentive to the necessary issues of the business and addressed any problems in a timely manner. Additionally, Mrs. Stuller was involved in the reconstruction of her home and competed in several horse shows, which required a significant investment of time for training.

Moreover, Mrs. Stuller had not specified which tax records she could not locate when the search for them began or the length of time she looked. The court remarked that because bank statements were the primary record used, Mrs. Stuller could have requested duplicate bank records but did not.[32] The court found it had no basis on which to conclude that the taxpayer could not produce the necessary records in time to file the return and therefore held the taxpayer liable for the late filing of the 2003 return. However, the court left open an avenue for an appeal, which Mrs. Stuller subsequently filed, by suggesting

27 *Williams v. Comm'r*, 16 T.C. 893, 905-06 (1951) (interpreting § 291 of the 1939 Code, a predecessor to IRC § 6651), *acq.*, 1951-2 C.B. 1. *See, e.g.*, *Harbour v. Comm'r*, T.C. Memo. 1991-532 (finding reasonable cause for failing to timely file because the taxpayer was in a coma the month before the due date of his tax return).

28 *Judge v. Comm'r*, 88 T.C. 1175, 1189-91 (1987).

29 55 F. Supp. 3d 1091 (C.D. Ill. 2014), *appeal docketed*, No. 15-1545 (7th Cir. Mar. 13, 2015).

30 Under IRC § 6511(a), a taxpayer generally has within three years from the time the return was filed or two years from the time the tax was paid, whichever period expires the later, to file a claim for refund.

31 IRC § 6532(a)(1). If a taxpayer has not received a response from the IRS regarding a claim for refund within six months from the time the refund claim was filed, the taxpayer can file a suit for refund in a United States District Court or the United States Court of Federal Claims.

32 *Estate of Stuller*, 55 F.Supp.3d at 1091, *appeal docketed*, No. 15-1545 (7th Cir. Mar. 13, 2015).

that evidence of a futile search for the records for weeks or months prior to the tax filing deadline might be sufficient for reasonable cause, in conjunction with the other circumstances.[33]

Reliance on Agent

The U.S. Supreme Court, in *United States v. Boyle*, held that taxpayers have a non-delegable duty to file a return on time.[34] The Court noted that "[i]t requires no special training or effort to ascertain a deadline and make sure that it is met."[35] Therefore, a taxpayer's reliance on an agent to file a return does not excuse any failure to comply with a known filing requirement.

For example, in *Specht v. United States*, Mrs. Specht (a co-fiduciary of the Escher estate), sought to recover penalties and interest in the amount of $1,198,261.38 imposed for failing to timely file the estate tax return and pay estate taxes.[36] Mrs. Specht, a 73-year-old high school-educated homemaker and the cousin of the deceased, was asked to be executor of the estate and formally accepted this role in February 2009. She hired Ms. Escher's former attorney, Mary Backsman, who had over 50 years of experience in estate planning, to represent the estate. Unknown to Mrs. Specht, Ms. Backsman was fighting brain cancer.

Ms. Backsman informed Mrs. Specht that the federal estate tax return was due by September 30, 2009, though she did not file it by that date. Additionally, Ms. Backsman failed to arrange for an agreed upon sale of stock to pay off the estate tax and lied to Mrs. Specht about it. She failed to file a first accounting of assets for the estate, missed probate deadlines, lied to Mrs. Specht about filing an extension, failed to file state estate tax returns, and failed to file the federal estate tax return. Ms. Backsman lied repeatedly about her handling of the situation. After discovering that Ms. Backsman had failed to request sale of the stock, Mrs. Specht fired her and hired another attorney on November 1, 2010. The estate filed a malpractice suit against Ms. Backsman that was settled.

Despite the above failures on the part of Ms. Backsman, the court determined that Mrs. Specht's reliance on her was unjustified. First, Mrs. Specht could not confirm if she had timely completed her listed obligations as a fiduciary and showed no concern about that duty. She stated in testimony that she was unsurprised Ms. Backsman had missed the filing deadline. She took no steps to proceed with the sale of stock before the deadline and received numerous warnings that Ms. Backsman was missing filing dates. Mrs. Specht did not attend probate hearings prior to the filing deadline. She received four notices from the probate court before the deadline, warning that Ms. Backsman was not performing her duties and that she had missed deadlines. After the deadline for filing the federal estate tax return had passed, Mrs. Specht received two more notices and was contacted in July and September 2010 by another client of Ms. Backsman, who warned her that Ms. Backsman was incompetent. In August 2010, she received a letter from the Ohio Department of Taxation alerting her that Ms. Backsman had not responded to their inquiries, and it could impose penalties. Lastly, in September 2010, she contacted an attorney who told her she needed to replace Ms. Backsman.

The court noted the precedent of *United States v. Boyle*, which established a distinction between relying on an attorney for legal advice and relying on an attorney to file tax returns, a non-delegable duty which

33 *Estate of Stuller v. U.S.*, *appeal docketed*, No. 15-1545 (7th Cir. Mar. 13, 2015).

34 *U.S. v. Boyle*, 469 U.S. 241 (1985).

35 *Id.* at 252.

36 *Specht v. U.S.*, 115 A.F.T.R.2d (RIA) 357 (S.D. Ohio 2015), *appeal docketed*, No. 15-3095 (6th Cir. Feb. 6, 2015).

requires no particular expertise.[37] "'Ordinary care and prudence' requires more than mere delegation."[38] The court also cited *Valen Mfg. Co. v. United States*, where a corporation's reliance on a bookkeeper who actively concealed a failure to file, did not establish reasonable cause.[39] This court clearly felt constrained by precedent, noting that while Ohio had refunded the estate tax penalties after the malpractice suit, it was "truly unfortunate that the United States did not follow the State of Ohio's lead."[40]

A taxpayer may establish reasonable cause for a failure to file if he or she can prove reasonable reliance on a professional tax advisor's substantive legal advice.[41] To reasonably rely on the advice of a tax professional, the taxpayer must present evidence of the professional's expertise and show he or she provided the professional with all necessary and accurate information.[42]

In *Cavallaro v. Commissioner*, the IRS issued a notice of deficiency to Mr. and Mrs. Cavallaro, determining a liability for the addition to tax under IRC § 6651(a)(1) in the amount of $29.6 million for the failure to file gift tax returns.[43] The court held that the IRS showed the additions to tax were applicable but sustained the Cavallaros' defenses of "reasonable cause."

Mr. and Mrs. Cavallaro had little to no advanced education, including no formal accounting, legal, or business education. They hired *advisers* who were competent professionals with sufficient expertise to justify reliance. They engaged professionals from a well-known accounting firm and a well-known law firm to structure the tax-free merger of their S corporation, Knight Tool Co., with their sons' S corporation, Camelot Systems, Inc. The merger transaction was eventually structured according to the advice given by the Cavallaros' attorney. Under this advice, it was determined that rights to technology developed by Knight Tool Co. (*i.e.*, a computer-controlled liquid dispensing machine known as CAM/ALOT) were previously transferred to Camelot Systems, Inc. prior to the merger and therefore could not be gifted to Camelot Systems, Inc. at the time of the merger.

The court found that taxpayers had reasonably relied upon their advisors. They had no formal legal, accounting, or business education and had hired competent professionals. Those professionals had

37 *Specht v. U.S.*, 115 A.F.T.R.2d (RIA) 357 (S.D. Ohio 2015) (citing *U.S. v. Boyle*, 469 U.S. 241 (1985)).

38 *Id.* (quoting *In re Carlson*, 126 F.3d 915, 922 (7th Cir.1997)).

39 *Id.* (S.D. Ohio 2015) (citing *Valen Mfg. Co. v. U.S.*, 90 F.3d 1190 (6th Cir.1996)).

40 *Id*. 115 A.F.T.R.2d (RIA) 357 (S.D. Ohio 2015), *appeal docketed*, No. 15-3095 (6th Cir. Feb. 6, 2015).

41 *Estate of La Meres v. Comm'r*, 98 T.C. 294, 315-17 (1992) (citations omitted).

42 *Id.* In her Annual Reports to Congress, the National Taxpayer Advocate has emphasized the need for minimum competency standards for paid unenrolled return preparers. *See* National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2008 Annual Report to Congress 504-12 (Most Litigated Issue: *Accuracy-Related Penalty Under Internal Revenue Code Sections 6662(b)(1) and (2)*). In June 2014, the IRS announced that it would be offering a new voluntary program designed to encourage education and filing season readiness for such preparers. This program allows unenrolled return preparers to obtain a record of completion when they voluntarily complete a required amount of continuing education, including a course in basic tax return filing issues and updates, ethics, and other federal tax law courses. Tax return preparers who elect to participate in the program and receive a record of completion from the IRS are included in a database on irs.gov to help taxpayers determine return preparer qualifications. *See* IRS Press Release, *New IRS Filing Season Program Unveiled for Tax Return Preparers*, IR-2014-75 (June 26, 2014); Rev. Proc. 2014-42, 2014-29 I.R.B. 192. The American Institute of Certified Public Accountants (AICPA) filed suit in the District Court for the District of Columbia, alleging that the IRS lacks the authority to implement the voluntary program. The government subsequently filed a motion to dismiss. On October 27, 2014, the District Court for the District of Columbia granted the IRS's motion to dismiss. On December 16, 2014, the AICPA filed an appeal with the Court of Appeals for the District of Columbia that has not yet been decided. *AICPA v. IRS*, 114 A.F.T.R.2d (RIA) 6451 (D.D.C. 2014), *appeal docketed*, No. 14-5309 (D.C. Cir. Dec. 16, 2014).

43 *Cavallaro v. Comm'r*, T.C. Memo. 2014-189, *appeal docketed*, No. 15-1368 (1st Cir. Mar. 24, 2015).

explicitly considered the relevant issue. Citing *Boyle*, the court noted that taxpayers are not required to challenge an attorney's tax advice to satisfy ordinary business care and prudence.[44] The court found the Cavallaros had provided accurate and necessary information to their advisors. They had relied sufficiently upon the advisors, and their tax positions were not attributable to themselves but to their advisors. The court concluded that the Cavallaros had reasonable cause for not filing a gift tax return and were not liable for the failure to file penalty.

"Zero Return" Filers and Other Frivolous Arguments

Under the longstanding four-part test articulated in *Beard v. Commissioner*,[45] a valid return must:

1. Contain sufficient data to calculate the tax liability;
2. Purport to be a return;
3. Represent an honest and reasonable attempt to satisfy the requirements of the tax laws; and
4. Be signed under penalties of perjury.

Each year, some taxpayers claim they have no obligation to pay taxes by filing returns reporting zero income when they have earned substantial wages that were accurately reported on a Form W-2. A "zero" return does not constitute a tax return under the *Beard* test because it is devoid of financial data and lacks sufficient information to calculate the tax liability.[46] Thus, when the taxpayers in *Waltner v. Commissioner* filed a return containing zeros for taxable income and total tax, the court upheld the failure to file penalty against the husband and wife.[47]

Failure to Pay an Amount Shown Penalty

A taxpayer can file a return by the due date and still be liable for a penalty under IRC § 6651(a)(2) if the amount shown on the return is not timely paid. In cases where individual taxpayers disputed that they were subject to the failure to pay penalty, many of their arguments for reasonable cause were similar to those used for the failure to file penalty under IRC § 6651(a)(1). The taxpayers often unsuccessfully argued medical illness or reliance on an agent or failed to make a separate and distinct argument relevant to the failure to pay.[48]

However, a taxpayer can prevail on the failure to pay penalty when the IRS cannot meet its burden of production under IRC § 7491(c). Specifically, the IRC § 6651(a)(2) penalty applies only when the taxpayer's filed return shows an amount due.[49] If the taxpayer did not file a return, the IRS can only assess the penalty if it has introduced a Substitute for Return (SFR) that satisfies the requirements of IRC § 6020(b). If the IRS cannot produce the SFR, it fails to meet its burden of production under IRC § 7491.[50]

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44 *Cavallaro v. Comm'r*, T.C. Memo. 2014-189 (citing *U.S. v. Boyle*, 469 U.S. 241 (1985)).

45 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

46 *See Cabirac v. Comm'r*, 120 T.C. 163 (2003). *See also U.S. v. Moore*, 627 F.2d 830, 835-36 (7th Cir.1980); *Turner v. Comm'r*, T.C. Memo. 2004-251.

47 *Waltner v. Comm'r*, T.C. Memo. 2014-133.

48 *See, e.g.*, *Central Motorplex, Inc. v. Comm'r*, T.C. Memo. 2014-207 (reliance on agent); *Akey v. Comm'r*, T.C. Memo. 2014-211 (medical illness); *U.S. v. Chelsea Brewing Co., LLC*, 114 A.F.T.R.2d (RIA) 5348 (S.D.N.Y. 2014) (financial hardship); *Villegas v. Comm'r,* T.C. Memo. 2015-33 (taxpayer offered "same excuses" for failure to pay as for failure to file); *Sodipo v. Comm'r*, T.C. Memo. 2015-3 (inability to file a tax return not reasonable cause for failure to pay), appeal docketed, No. 15-2089 (4th Cir. Sept. 16, 2015).

49 IRC §§ 6651(a)(2), (g)(2).

50 *See Wheeler v. Comm'r*, 127 T.C. 200, 210 (2006), *aff'd*, 521 F.3d 1289 (10th Cir. 2008).

For example, in *El v. Commissioner*, the taxpayer failed to file a return and pay taxes for 2009.[51] The IRS determined a deficiency and imposed penalties under IRC §§ 6651(a)(1) and (2) for failure to file and failure to pay.

To impose the failure to pay penalty in the case, the IRS was required to introduce an SFR, because the taxpayer did not file an original return for 2009.[52] The IRS conceded that it failed to meet its burden of production, as an SFR had not been introduced into evidence. On that basis, the court held the taxpayer not liable for the IRC § 6651(a)(2) failure to pay penalty.

Estimated Tax Penalty

Courts routinely found taxpayers liable for the IRC § 6654 estimated tax penalty when the IRS proved the taxpayer:

- Had a tax liability;
- Had no withholding credits;
- Made no estimated tax payments for that year; and
- Offered no evidence to refute the IRS.

The IRS has the burden of production under IRC § 7491(c) to produce evidence that a taxpayer was required to make an annual payment under IRC § 6654(d)(1)(B).

For example, in *Muncy v. Commissioner*, the taxpayer, who worked at a tire store, failed to file income tax returns and pay estimated taxes for tax years 2000 through 2005.[53] He insisted on halting his tax withholding and claimed the status of independent contractor though no aspect of his job was altered. A third-party entity would receive his wages and disburse them to the taxpayer's trusts or nominee accounts. The entity receiving his wages did not issue him Forms W-2, 1099, or any other forms for the income distributions, at his instruction. In 2010, he pleaded guilty to one criminal count of willfully attempting to evade income taxes for 2004. The taxpayer was placed on probation by the court and was required to file income tax returns as a condition of his probation.[54] In 2011, the IRS sent a notice of deficiency for tax years 2000 through 2005, which included estimated tax penalties under IRC § 6654.

In regard to the estimated tax penalty imposed, the court noted that the IRS burden of production requires evidence that there was a "required annual payment" under IRC § 6654(d)(1)(B). The required annual payment is the lesser of: (1) 90 percent of the reported tax for that year (or the tax due, if no return is filed), or (2) 100 percent of the tax shown on the return for the immediately preceding taxable year.[55] In situations where there was no return filed for the preceding year, the second clause is ignored.[56] Thus, the taxpayer's required payment in this case was 90 percent of the tax due, as determined by the IRS, for each of the tax years 2001 through 2005. For 2000, the IRS was obligated to introduce the tax return filed in 1999 so that the court could calculate the required annual payment from the lesser of the

51 *El v. Comm'r*, 144 T.C. No. 9 (2015).
52 *See* IRC §§ 6651(g), 6020(b); *Cabirac v. Comm'r*, 120 T.C. 163, 170 (2003).
53 *Muncy v. Comm'r*, T.C. Memo. 2014-251, *appeal docketed*, No. 15-1626 (8th Cir. Mar. 26, 2015).
54 *U.S. v. Muncy*, No. 4:10-cr-00018-BSM (E.D. Ark. filed Jan. 8, 2010).
55 IRC § 6654(d)(1)(B).
56 *Id*.

two amounts under IRC § 6654(d)(1)(B).[57] As that return was not provided, the court was unable to conclude that there was a required annual payment for 2000. It held the taxpayer liable for the failure to pay estimated tax penalty for the years 2001 through 2005, but not for 2000.

A similar issue arose in *United States v. Nichols*, where the taxpayers filed "zero returns."[58] A zero return is filed with the IRS but erroneously lists zero as the amount of tax due. It is not considered a valid return as there was no honest intent to provide the required information.[59] The IRS provided Forms 4340, *Certificate of Assessments, Payments, Other Specified Matters*, instead of SFRs to the court. The court held these as sufficient to impose the failure to file penalties but not for the failure to pay estimated tax penalties. Because the IRS calculates the required annual payment under IRC § 6654 using the tax due as reported by the taxpayer on his return, the estimated payment for the taxpayers' zero returns was zero.[60]

Penalty for Raising Frivolous Arguments

In four cases where the IRS had asserted either the failure to file penalty, failure to pay penalty, estimated tax penalty, or some combination thereof, the courts also imposed the IRC § 6673 penalty for making frivolous arguments.[61] In general, the courts are hesitant to impose this penalty without prior warning and in seven cases this period, the courts warned the taxpayers against making future frivolous arguments.[62]

In *Rader v. Commissioner*, the taxpayer did not report income from his plumbing business and did not file tax returns for five years.[63] The taxpayer argued that he was not legally required to file a return and that SFRs were not valid for purposes of a failure to pay penalty. He also claimed a Fifth Amendment privilege against self-incrimination. The court rejected these claims as meritless. A frivolous position is one contrary to established law and unsupported by a reasoned argument for change in the law.[64] At the conclusion of the trial, the court invoked the IRC § 6673(a)(1) penalty for frivolous arguments and held the taxpayer liable for a $10,000 penalty. Penalties for failure to file, failure to pay, and failure to pay estimated tax were also upheld.

CONCLUSION

The IRS did not prevail in full in 11 of 63 (or 17 percent) of the failure to file, failure to pay, and the estimated tax penalty cases analyzed in this report. Considering the limited resources most taxpayers have when litigating a case against the IRS, and the immense resources possessed by the IRS, a 17 percent success rate seems unexpectedly high. This is similar to the prior year, when the IRS did not prevail in 13 percent of cases.[65] In the cases the IRS lost, the most common problem was the IRS's failure to meet its burden of production.

57 *See Wheeler v. Comm'r*, 127 T.C. 200, 211–12 (2006) (requiring evidence of the prior year's return to determine the required annual payment).

58 *U.S. v. Nichols*, 115 A.F.T.R.2d (RIA) 1971 (E.D. Wash. 2015).

59 *See Cabirac v. Comm'r*, 120 T.C. 163 (2003).

60 *U.S. v. Nichols*, 115 A.F.T.R.2d (RIA) 1971 (E.D. Wash. 2015) (citing *Linmar Prop. Mgmt. Trust v. Comm'r*, T.C. Memo. 2008-219 (2008)).

61 *See* Most Litigated Issue: *Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions*, *infra*.

62 *See, e.g.*, *Kernan v. Comm'r*, T.C. Memo. 2014-228 (imposing no IRC § 6673 penalty on a taxpayer who believed he was not required to file a return unless personally invited to file), *appeal docketed*, No. 15-70574 (9th Cir. Feb. 25, 2015).

63 *Rader v. Comm'r*, 143 T.C. 376 (2014).

64 *Goff v. Comm'r*, 135 T.C. 231, 237 (2010).

65 National Taxpayer Advocate 2014 Annual Report to Congress 495.

It is critical that IRS employees look closely and thoroughly at the case facts when assessing reasonable cause claims rather than solely relying on the Reasonable Cause Assistant (RCA) software,[66] which is designed to help IRS employees make fair and consistent abatement determinations.[67] The RCA program allows IRS employees to override the results in certain circumstances, but employees must understand the definition of reasonable cause to apply the override.[68] Thus, a close review by an employee is essential to ensure the failure to file penalty or the failure to pay penalty is imposed appropriately. To promote voluntary compliance and to uphold a taxpayer's *right to a fair and just tax system* and the *right to pay no more than the correct amount of tax*, the facts of taxpayers' individual cases must be carefully considered.

66 The Reasonable Cause Assistant can only consider failure to file or failure to pay penalties for certain individual tax returns, and the failure to deposit penalty only for certain business returns.

67 National Taxpayer Advocate 2010 Annual Report to Congress 198 (Most Serious Problem: *The IRS's Over-Reliance on Its "Reasonable Cause Assistant" Leads to Inaccurate Penalty Abatement Determinations*). *See also* IRS, *Reasonable Cause Assistant (RCA) Usability Test Final Report Summary* 4 (May 28, 2010). The test showed that employees using the RCA determined penalty abatement requests correctly in only 45 percent of the cases. An even more disturbing finding was that all of the employees in the study believed they were making correct legal determinations based on reasonable cause.

68 IRM 20.1.1.3.6.10(3) (Nov. 25, 2011) ("[F]air and consistent application of penalties requires employees to make a final penalty relief determination consistent with the RCA conclusion … [U]nderstanding that the individual facts and circumstances vary for each case and that there may be unique facts and circumstances in certain cases that RCA cannot consider, an 'override (abort)' function is available in RCA.").

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

SUMMARY

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in 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.[1]

TAXPAYER RIGHTS IMPACTED[2]

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

PRESENT LAW

IRC § 7403 authorizes the United States to enforce a federal tax lien with respect to a taxpayer's delinquent tax liability or to subject any property, right, title, or interest in property of the delinquent taxpayer to the payment of a liability, by initiating a civil action against the taxpayer in the appropriate United States District Court.[3] All parties having liens on or otherwise claiming interest in the relevant property shall be made parties to the action.[4] The law of the state where the property is located determines the nature of a taxpayer's legal interest in the property.[5] However, if it is determined that the taxpayer has an interest in the property, federal law controls whether the property is exempt from attachment of the lien.[6]

The court may order an officer of the court to sell the property and apply the proceeds to the delinquent tax liability.[7] However, based on the Supreme Court case *United States v. Rodgers*, the court is not required to authorize a forced sale and may exercise limited equitable discretion.[8] When a forced sale involves the interests of a non-delinquent third party, the court should consider four factors from *Rodgers* when determining whether the property should be sold:

1. The extent to which the government's financial interests would be prejudiced if they were relegated to a forced sale of the partial interest of the delinquent taxpayer;

1 National Taxpayer Advocate 2014 Annual Report to Congress 503.
2 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.
3 IRC § 7403(a); Treas. Reg. § 301.7403-1(a).
4 IRC § 7403(b).
5 *U.S. v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985).
6 *U.S. v. Rodgers*, 461 U.S. 677 (1983).
7 IRC § 7403(c).
8 461 U.S. 677 (1983).

2. Whether the innocent third party with a separate interest in the property, in the normal course of events, has a legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or taxpayer's creditors;
3. The likely prejudice to the third party in personal dislocation costs and inadequate compensation; and
4. The relative character and value of the non-liable and liable interests held in the property.[9]

At the sale of the property in which it holds a first lien, the United States may bid an amount equal to or less than the amount of the lien, plus selling expenses.[10] Additionally, the United States may intervene in foreclosure actions initiated by other creditors to assert any lien on the property that is the subject of such action.[11]

The United States may also remove the case to a U.S. District Court if the case was initiated in a state court.[12] However, junior federal tax liens may be effectively extinguished in a foreclosure and sale under state law, even if the United States is not a party to the proceeding.[13] The IRC specifically authorizes the court to appoint a receiver to enforce the lien and upon the government's certification that it is in the public interest, to appoint a receiver with all powers of a receiver in equity to preserve and operate the property prior to the sale.[14]

In 2015, the IRS issued an updated Internal Revenue Manual (IRM) incorporating the interim guidance detailing the procedures the IRS should use when referring cases to the Department of Justice (DOJ) when seeking to recommend a suit to foreclose on a taxpayer's principal residence.[15] When a tax lien attaches to the principal residence of a taxpayer or a residence owned by the taxpayer but occupied by the taxpayer's spouse, former spouse, or minor child, the IRS can use two methods to enforce the tax lien. The IRS can request that the DOJ:

- File suit to foreclose the federal tax lien against the principal residence under IRC § 7403; or
- Commence a proceeding to obtain a court order allowing administrative seizure of a principal residence under IRC § 6334(e)(1).[16]

9 461 U.S. 677 (1983) at 709-11.

10 IRC § 7403(c).

11 However, if the application of the United States to intervene is denied, the adjudication will have no effect upon the federal tax lien on the property. IRC § 7424. Under 28 U.S.C. § 2410, the United States may be named a party in any civil action or suit in any district court, or in any state court having jurisdiction of the subject matter. IRC § 7424.

12 28 U.S.C. § 1444.

13 *U.S. v. Brosnan*, 363 U.S. 237 (1960).

14 IRC §§ 7403(d) and 7402(a).

15 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Mar. 30, 2015). This updated IRM is the result of action by TAS leadership. In 2012, TAS Systemic Advocacy developed and issued to the IRS an Advocacy Proposal recommending that the IRS consider the negative impact on the taxpayer of a suit to foreclose on a principal residence prior to forwarding the case to the DOJ. TAS, *Memorandum for Director, Collection Policy* (Aug. 20, 2012). The National Taxpayer Advocate followed this advocacy proposal with a legislative recommendation that Congress amend IRC § 7403 to require that the IRS, before recommending that the Attorney General file a suit to foreclose, first determine whether the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, and that the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer. National Taxpayer Advocate 2012 Annual Report to Congress 537-43 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*). Following this recommendation, Systemic Advocacy consulted extensively with the IRS to develop an Internal Guidance Memorandum. *See* IRS Interim Guidance Memorandum SBSE-0413-035 (Apr. 30, 2013). This guidance was later reissued in IRS Interim Guidance Memorandum SBSE-0414-0032 (Apr. 18, 2014).

16 IRC § 6334(e)(1) requires that the IRS obtain court approval prior to administratively seizing a principal residence.

Prior to the interim guidance, IRM provisions related to referring a case to the DOJ for administrative seizure of a principal residence under IRC § 6334(e)(1) required the IRS to consider who is living in the residence and to verify if economic hardship currently exists (or would be created by the seizure) in determining whether referral was appropriate, but not if the IRS was referring the matter to the DOJ for a foreclosure suit under IRC § 7403.[17] The updated IRM states that the IRS would refer a case to DOJ to pursue a suit to foreclose only when there are no reasonable administrative remedies and hardship issues. The IRM now requires the suit recommendation narrative to contain the results of the following actions:

- Attempt to personally contact the taxpayer and inform them that a suit to foreclose the tax lien on the principal residence is the next planned action;
- Attempt to identify the occupants of the principal residence;
- Discuss administrative remedies with the taxpayer such as an offer in compromise (including Effective Tax Administration offer or an offer with consideration of special circumstances);
- Advise the taxpayer about TAS, provide Form 911, *Request for Taxpayer Advocate Assistance (and Application for Taxpayer Assistance Order*), and explain its provisions;[18] and
- Include a summary statement in the case history, along with the information on the taxpayer and the occupants of the principal residence including children.[19]

ANALYSIS OF LITIGATED CASES

We reviewed 44 opinions issued between June 1, 2014, and May 31, 2015 that involved civil actions to enforce federal tax liens. Table 7 in Appendix 3 contains a detailed list of those cases. Forty-one percent of the taxpayers appeared *pro se*, and 59 percent were represented. Taxpayers with representation received full relief in three cases and partial relief in one case. *Pro se* taxpayers did not receive full or partial relief in any cases.

Foreclosure of Tax Liens Against Property With Non-Liable Spouse

In *Cardaci v. United States*,[20] a husband and wife purchased a residence as joint tenants by the entirety in 1978. The home was the only real property owned by the taxpayers (Mr. and Mrs. Cardaci) and had been their marital residence since the purchase. The United States filed suit to foreclose the tax lien on the taxpayers' residence to satisfy, in whole or in part, the taxes assessed against Mr. Cardaci for unpaid employment taxes his business owed. Mr. Cardaci's business had failed to remit withheld payroll taxes to the IRS for tax year 2000 and one-quarter of tax year 2001 while simultaneously paying its employees and suppliers.

The court held a bench trial to determine if it should exercise its discretion and declined to order the foreclosure sale of the residence. Since the wife was a non-liable third party, the court applied the *Rodgers* factors to determine whether foreclosure of the tax lien on the residence was appropriate.[21] The court

17 *Cf*. IRM 5.10.2.18(5) (Aug. 4, 2015), IRM 5.10.2.19(1) 5.10.2.19(1) (Aug. 4, 2014) and IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Mar. 30, 2015).

18 If the taxpayer indicates that the planned foreclosure of the principal residence would create a hardship, the Revenue Officer (RO) is instructed to assist the taxpayer with the preparation of Form 911 and should forward the form to the local TAS office if the RO cannot or will not provide the requested relief.

19 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Mar. 30, 2015).

20 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014), *appeal docketed*, No. 14-4237 (3d Cir. Oct. 27, 2014).

21 *Id*. For discussion of the *Rodgers* factors, see Present Law section, *supra*.

considered all factors and found that the factor concerning the value of liable and non-liable interests weighed substantially in favor of not forcing a sale of the property.

The government argued Mr. and Mrs. Cardaci's interests in the property were equal (50/50) because they both were roughly the same in age and owned a half interest. The court rejected that argument and instead found the valuation was more complicated as it had to take into account the value of Mrs. Cardaci's right to survivorship. The court reasoned that the Cardacis owned the property as tenants by the entirety, and as such, each spouse was a tenant in common with the other spouse during the joint lives of the couple. A forced sale would sever the tenancy much like a divorce decree or voluntary sale. However, in such situations, the division of the proceeds would occur after the spouses freely surrendered their survivorship interest. In this case the tenancy had not yet been severed, and Mrs. Cardaci had not surrendered the equivalent of a life estate nor her right to withhold consent of the sale. Thus, the valuation of her interest was deemed more complicated than in a divorce case because it had to account for the value of her survivorship interest. Accordingly, the court agreed that Mrs. Cardaci's right of survivorship had value and determined that the government would only be entitled to 14 percent of the sale price of the home, amounting to only a little over $14,000 for the government after expenses.[22] The court further determined that this result would be nominal compared to Mr. Cardaci's tax debt of over $80,000. It ordered the Cardacis to pay one-half of the fair market rental value of their home every month until the tax debt was satisfied. In the event that Mr. Cardaci survives Mrs. Cardaci, the court held that the government could then seek the forced sale of the residence to satisfy any remaining portion of the tax debt.[23]

In *United States v. Baker*,[24] the United States filed suit to foreclose tax liens on two parcels of land located in New Hampshire to satisfy in part the delinquent tax liabilities of the taxpayer, Scott Baker. The taxpayer married Robin Baker in 1998. In 2000, the taxpayer and his wife purchased the property the government sought to foreclose as joint tenants with the rights of survivorship. In 2008, the couple divorced. Pursuant to the divorce judgment, the taxpayer's wife was awarded the properties in question. The divorce judgment required the judgment and deed transferring the properties be recorded. However, neither the taxpayer nor the taxpayer's wife ever recorded the deeds or the judgment. In 2009, the IRS made assessments against the taxpayer and filed a Notice of Federal Tax Lien.

The government argued in the foreclosure proceeding that the tax lien for the taxpayer's liabilities attached to the properties that the wife, a non-liable third party, received pursuant to the divorce. The government claimed that its tax liens are "entitled to priority over the divorce judgment because neither the judgment nor any related deed was ever recorded."[25]

The court applied New Hampshire state law which provides that an undivided interest in real estate, apportioned by a divorce judgment, vests in the grantee spouse "by the mere force of the decree."[26] Thus, the court ruled against the government holding that the taxpayer had no rights to the properties to which the tax lien could attach. The court found that the taxpayer lost his right to own, transfer, or encumber the properties when the divorce judgment became final.

22 *U.S. v. Cardaci*, 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014), *appeal docketed*, No. 14-4237 (3d Cir. Oct. 27, 2014).
23 *Id*.
24 *U.S. v. Baker*, 114 A.F.T.R.2d (RIA) 5772 (D.N.H. 2014).
25 *Id*.
26 The *Baker* court cited *Swett v. Swett*, 49 N.H. 264, 264 (1870) (quoting *Whittier v. Whittier*, 31 N.H. 452, 458-59 (1855)).

Foreclosure of Tax Liens Against Property Held by a Taxpayer's Nominee or Alter Ego

At least 13 opinions identified this year involved foreclosure of federal tax liens against property titled in the name of a taxpayer's nominee or alter ego. A nominee is one "who holds bare legal title to property for the benefit of another."[27] Courts typically look at a number of factors to determine whether an entity is a nominee of a taxpayer, such as whether:

- The nominee paid no or inadequate consideration;
- The property was placed in the name of the nominee in anticipation of the tax debt or litigation;
- There is a close relationship between the transferor and the nominee;
- The parties to the transfer never recorded the conveyance;
- The transferor retained possession (or control); and
- The transferor continues to enjoy the benefits of property.[28]

For example, in *United States v. Jones*,[29] the court held the trust set up by the taxpayer was the nominee of the taxpayer. The court based this conclusion on the fact that the taxpayer admitted he had "full use, enjoyment, and control over the subject property," which included residing there, renting out the property and receiving the rents, and paying all utilities and taxes associated with the property.[30] Since Jones' transfer to the trust was invalid because the trust served as the taxpayer's nominee, the court found the title to the property was in the name of the taxpayer, and therefore, the United States was entitled to foreclose its lien on the property.

In *United States v. O'Shea*,[31] the court determined that married taxpayers who had dealings with a trust promoter convicted of tax evasion crimes held their properties in sham trusts. The court considered the totality of circumstances, finding that the taxpayers exercised control over the parcels of land when the properties were held by the trusts.

The factors weighing in favor of a determination of control were the inadequate consideration received for the conveyance of the property and the taxpayers continuing to enjoy the benefits of ownership, including using the properties for their residence and their business and paying all the property expenses. As the property was held by nominees or alter egos of the taxpayers, the United States was entitled to foreclose on the four parcels of land. The court ordered the sham trusts be set aside and disregarded for tax purposes. In a subsequent appeal of this case, the U.S. Court of Appeals for the 4th Circuit affirmed the U.S. District Court for the Southern District of West Virginia in favor of the government.[32]

CONCLUSION

In the 2012 Annual Report to Congress, we anticipated an increase in court opinions involving lien enforcement in the coming years because the number of cases IRS referred to the DOJ spiked from 204

27 Black's Law Dictionary (10th ed. 2014), *available at* http://westlaw.com. *See also U.S. v. Sabby*, 113 A.F.T.R.2d (RIA) 1335 (D. Minn. 2014) (quoting *Scoville v. U.S.*, 250 F.3d 1198, 1202 (8th Cir. 2001)).

28 *See, e.g.*, *U.S. v. Jones*, 114 A.F.T.R.2d (RIA) 6126 (D. Wyo. 2014) (quoting *Holman v. U.S.*, 505 F.3d 1060, 1065 (10th Cir. 2007)); *U.S. v. Sabby*, 113 A.F.T.R.2d (RIA) 1335 (D. Minn. 2014) (quoting *Scoville v. U.S.*, 250 F.3d 1198, 1202 (8th Cir. 2001)).

29 114 A.F.T.R.2d (RIA) 6126 (D. Wyo. 2014).

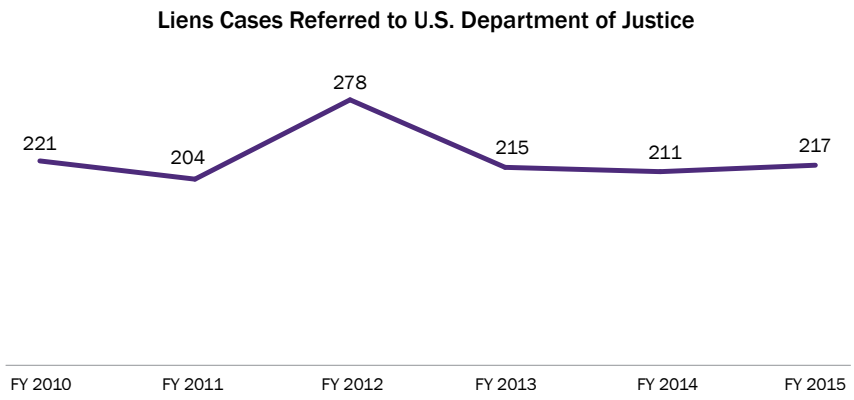
30 *Id*.

31 *U.S. v. O'Shea*, 115 A.F.T.R.2d (RIA) 887 (S.D.W. Va. 2015), *aff'd by* 116 A.F.T.R.2d (RIA) 5389 (4th Cir. 2015).

32 *U.S. v. O'Shea*, 116 A.F.T.R.2d (RIA) 5389 (4th Cir. 2015).

in fiscal year (FY) 2011 to 278 in FY 2012.[33] While there was a marked increase in lien enforcement opinions issued in reporting year 2014, from 33 in 2013 to 52 in 2014, the number of opinions issued this year fell to 44.[34] It is unclear whether the 2014 increase in the number of litigated cases was directly related to a greater number of cases referred to DOJ in FY 2012. The number of referrals decreased to 215 in FY 2013, and slightly fluctuated thereafter, with 211 cases referred in FY 2014 and 217 in FY 2015, as shown on Figure 3.7.1 below.[35]

FIGURE 3.7.1, The Number of Cases Referred to the DOJ by Fiscal Year.[36]



The National Taxpayer Advocate anticipates the updated IRM will have a positive effect on taxpayer rights in future years, as the IRS refers fewer suits to foreclose tax liens on taxpayers undergoing a hardship or in situations where there are reasonable alternatives. The National Taxpayer Advocate continues to recommend that Congress adopt the previous legislative recommendation to codify the approach used in the IRM.[37]

To address taxpayer burden and enhance the taxpayer *rights to privacy, to a fair and just tax system*, and *to appeal an IRS's decision in an independent forum*, the National Taxpayer Advocate has also recommended that Congress amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to "affected third parties," known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.[38] Such cases represented about 30 percent (13 of 44) of lien cases seen in this reporting period.

33 National Taxpayer Advocate 2012 Annual Report to Congress 639.

34 There were 48 opinions issues in 2012. National Taxpayer Advocate 2012 Annual Report to Congress 634.

35 National Taxpayer Advocate 2014 Annual Report to Congress 508 (FY 2010 to FY 2013). DOJ Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 2014), and DOJ Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 2015).

36 *Id*.

37 The National Taxpayer Advocate recommended Congress amend IRC § 7403 to require that the IRS, before recommending that the Attorney General file a suit to foreclose, first determine that the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, and that the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer. National Taxpayer Advocate 2012 Annual Report to Congress 537-43 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*).

38 National Taxpayer Advocate 2012 Annual Report to Congress 544-52 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).

MLI #8 Charitable Deductions Under IRC § 170

SUMMARY

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.[1] To take a charitable deduction, taxpayers must contribute to a qualifying organization[2] and substantiate contributions of $250 or more. Litigation generally arises over one or more of these 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 resulted in a split decision.

TAXPAYER RIGHTS IMPACTED[3]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

PRESENT LAW

Taxpayers must itemize to claim any charitable contribution deduction and generally are able to take a deduction for charitable contributions made within the taxable year.[4] Transfers to charitable organizations are deductible only if they are contributions or gifts,[5] not payments for goods or services.[6] A contribution or gift will be allowed as a deduction under Interal Revenue Code (IRC) § 170 only if it is made "to" or "for the use of" a qualifying organization.[7]

1 Internal Revenue Code (IRC) § 170.

2 To claim a charitable contribution deduction, a taxpayer must establish that he or she made a gift to a qualified entity organized and operated exclusively for an exempt purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual. IRC § 170(c)(2).

3 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

4 IRC §§ 63(d) and (e), 161, and 170(a).

5 The Supreme Court of the United States has defined "gift" as a transfer proceeding from a "detached and disinterested generosity." *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960).

6 *See also* Treas. Reg. § 1.170A-1(g) (no deduction for contribution of services).

7 IRC § 170(c).

For individuals, charitable contribution deductions are generally limited to 50 percent of the taxpayer's contribution base (adjusted gross income computed without regard to any net operating loss carryback to the taxable year under IRC § 172).[8] However, subject to certain limitations, individual taxpayers can carry forward unused charitable contributions in excess of the 50 percent contribution base for up to five years.[9] Corporate charitable deductions are generally limited to ten percent of the taxpayer's taxable income.[10] Taxpayers cannot deduct services that they offer to charitable organizations; however, incidental expenditures incurred while serving a charitable organization and not reimbursed may constitute a deductible contribution.[11]

Substantiation

For cash contributions, taxpayers must maintain receipts from the charitable organization, copies of cancelled checks, or other reliable records showing the name of the organization, the date, and the amount contributed.[12] Deductions for single charitable contributions of $250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.[13]

The donor is generally required to obtain the contemporaneous written acknowledgment no later than the date he or she files the return for the year in which the contribution is made, and it must include:

- The name of the charitable organization;
- The amount of any cash contribution;
- A description (but not the value) of any non-cash contribution;
- A statement that no goods or services were provided by the organization in return for the contribution, if that was the case;
- A description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution; and
- A statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits, if that was the case.[14]

For each contribution of property other than money, taxpayers generally must maintain a receipt showing the name of the recipient, the date and location of the contribution, and a description of the property.[15] When taxpayers contribute property other than money, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.[16] This general rule is subject to certain exceptions that in some cases limit the deduction to the taxpayer's cost basis in the property.[17]

8 IRC §§ 170(b)(1)(A) and (G).

9 IRC § 170(d)(1).

10 IRC § 170(b)(2).

11 Treas. Reg. § 1.170A-1(g). Meal expenditures in conjunction with offering services to qualifying organizations are not deductible unless the expenditures are away from the taxpayer's home. *Id*. Likewise, travel expenses associated with contributions are not deductible if there is a significant element of personal pleasure involved with the travel. IRC § 170(j).

12 Treas. Reg. § 1.170A-13(a)(1).

13 IRC § 170(f)(8). *See also* Treas. Reg. § 1.170A-13(f).

14 IRS Pub. 1771, *Charitable Contributions Substantiation and Disclosure Requirements* (Rev. July 2013).

15 Treas. Reg. §§ 1.170A-13(b)(1)(i) to (iii).

16 Treas. Reg. § 1.170A-1(c)(1).

17 *Id*. Note that the deduction is reduced for certain contributions of ordinary income and capital gain property. *See* IRC § 170(e).

For claimed contributions exceeding $5,000, the taxpayer must obtain a qualified appraisal prepared by a qualified appraiser.[18]

ANALYSIS OF LITIGATED CASES

We reviewed 28 decisions entered between June 1, 2014 and May 31, 2015, involving charitable contribution deductions claimed by taxpayers. Table 8 in Appendix 3 contains a detailed list of those cases. Of the 28 cases, 16 involved the taxpayers' substantiation (or lack thereof) of the claimed contribution, nine cases involved a dispute over the valuation of property contributed, another ten involved the contribution of an easement, and one case involved a trust's payments to a scholarship.[19]

Qualified Conservation Contribution

For a gift to constitute a qualified contribution under IRC § 170, the donor-taxpayer must possess a transferrable interest in the property and intend to irrevocably relinquish all rights, title, and interest to the property without any expectation of some benefit in return.[20] Taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayers' entire interest in that property.[21] Nevertheless, taxpayers may deduct the value of a contribution of a partial interest in property that constitutes a "qualified conservation contribution,"[22] also known as a conservation easement. A contribution will constitute a qualified conservation contribution only if it is of a "qualified real property interest" made to a "qualified organization" "exclusively for conservation purposes."[23]

In *Belk v. Commissioner*, the taxpayers, a married couple who filed a joint return, purchased a large tract of land outside of Charlotte, North Carolina for the development of a residential community.[24] They formed a limited liability company (LLC) to develop the land into a golf course and 402 residential lots and then contributed the property to the LLC.[25] Several years later, the taxpayers executed a conservation easement over 184 acres that contained the golf course and transferred the easement to Smoky Mountain National Land Trust, Inc.[26] Although the easement was "for outdoor recreation" and prohibited further development, the taxpayers had granted the easement in perpetuity, subject to certain "Reserved Rights," including the right for the taxpayers to "substitute an area of land owned by [it] which is contiguous to the Conservation Area for an equal or lesser area of land comprising a portion of the Conservation Area."[27] This "Reserved Right" essentially provided the taxpayers with the ability to "swap land in and

18 IRC § 170(f)(11)(C). "Qualified appraisal" and "qualified appraiser" are defined in IRC §§ 170(f)(11)(E)(i) and (ii), respectively.

19 Cases addressing more than one described issue are counted for each issue. For example, cases addressing the valuation of easements are counted once as a valuation issue case and again as a conservation easement issue case. As a result, the breakdown of case issues above will not add up to the total number of cases reviewed by TAS.

20 IRC § 170(f)(3).

21 *Id*.

22 IRC § 170(b)(1)(E).

23 IRC § 170(h)(1)(A)-(C). IRC § 170(h)(4)(B)(i) provides that, in the case of a contribution that consists of a restriction with respect to the exterior of a certified historic structure, the contribution must satisfy two requirements in order to be considered "exclusively for conservation purposes": 1) the interest must include a restriction which preserves the entire exterior of the building, and 2) the interest must prohibit any change to the exterior of the building that is inconsistent with the historic character of the exterior.

24 774 F.3d 221, 223 (4th Cir. 2014), *aff'g* 140 T.C. 1 (2013).

25 *Id*.

26 *Id*.

27 *Id*. The substitution right is conditional upon the Trust's agreement that the "substitution property is of the same or better ecological stability," the "substitution shall have no adverse effect on the conservation purposes," and that "the fair market value of the substituted property is at least equal to that of the property originally subject to the Easement." *Id*.

out of the Easement" and to shift the use restriction from one parcel of land to another.[28] The taxpayers claimed a deduction of over $10.5 million for the donation of the easement in 2004, along with carryover in 2005 and 2006, but the IRS disallowed the deduction on the basis that it was not a "qualified conservation contribution."[29] The Tax Court upheld the IRS's determination finding that the taxpayers "failed to donate an interest in real property that is subject to a use restriction granted in perpetuity."[30]

On appeal, the 4th Circuit affirmed the disallowance and ruled that the easement failed to meet the requirements of IRC § 170(h)(2) since it was not subject to a use restriction in perpetuity.[31] The court explained that because the "taxpayer may remove land from the defined parcel and substitute other land," the restriction on "the real property" is not in perpetuity.[32] The court found that a conservation easement is not a "qualified real property interest," as described in IRC § 170(h)(2)(C), if the terms of the easement agreement allow the grantor to change which property is subject to the easement.[33]

In *Mitchell v. Commissioner*, the taxpayers, a married couple, purchased land subject to a mortgage.[34] Several years later, the taxpayers contributed the land, subject to the mortgage, to a family limited liability partnership. The partnership then granted a conservation easement of almost 200 acres of unimproved land to the Montezuma Land Conservancy to be used as open space for wildlife and agricultural purposes in 2003.[35] The deed of conservation easement in gross purported to transfer the easement to the Montezuma Land Conservancy in perpetuity; however, at the time of the donation, the taxpayers had not obtained a mortgage subordination agreement from a third party.[36] The taxpayers claimed a deduction for the transfer on their 2003 income tax return, but it was not until 2005 that the third party agreed to subordinate his interest in the property to the easement.

In 2010, the IRS disallowed the deduction due to the fact that Montezuma Land Conservancy's interest in the property was subject to a third party's unsubordinated mortgage at the time of donation, thus, the conservation purpose was not protected in perpetuity.[37] Although the IRC does not specifically define "protected in perpetuity," under IRC § 170(h)(5)(A), the IRS has issued regulations on this subject and has excluded deductions where there is not a mortgage subordination.[38] The taxpayers argued that the regulations did not specify an explicit timeframe for subordinating the mortgage; however, the court rejected this and determined that the plain language of the regulation required the mortgage subordination to have occurred prior to the donation for it to be eligible for a deduction.[39] The 10th Circuit affirmed the Tax Court's determination that the conservation easement donation failed to comply with

28 *Belk,* 774 F.3d at 223-24).

29 *Id*. at 224.

30 *Belk v. Comm'r*, 140 T.C. 1, 10-11 (2013).

31 *Belk*, 774 F.3d at 226.

32 *Id.*

33 *Id.* at 227. The Tax Court made a similar determination and cited *Belk v. Comm'r* in *Balsam Mountain Invs., LLC v. Comm'r*, T.C. Memo. 2015-43 (holding that a conservation easement that allows for a future boundary adjustment is not a "qualified real property interest" and thus not eligible for a charitable contribution deduction), *appeal docketed*, No. 15-2010 (4th Cir. Sept. 3, 2015).

34 775 F.3d 1243 (10th Cir. 2015), *aff'g* 138 T.C. 324 (2012).

35 *Id*. at 1245-46.

36 *Id*. at 1246.

37 *Id*.

38 *Id. See* Treas. Reg. § 1.170A-14(g).

39 *Mitchell*, 775 F.3d at 1248, 1250-51.

the mortgage subordination requirements due to the fact that the third party's mortgage encumbering on the land was not subordinated until after the donation.[40]

As both cases illustrate, it is vital for a conservation easement to be protected in perpetuity for it to qualify as a "qualified conservation contribution" pursuant to the IRC and Treasury regulations.[41] To be considered protected in perpetuity, the conservation easement must be limited to a "single, immutable parcel" for the life of the easement,[42] and the property upon which the easement is granted must not be subject to an unsubordinated mortgage.[43]

Conservation Easement Valuation

To receive a deduction for most contributions of property in excess of $5,000, taxpayers must provide a qualified appraisal of the property that is donated.[44] In *Scheidelman v. Commissioner*, the taxpayer lived in a townhouse in a historic district.[45] She donated an architectural façade conservation easement to the National Architectural Trust and claimed a charitable deduction for the contribution.[46] The taxpayer retained a real estate appraiser to value the donation,[47] which was found to be $115,000. The IRS determined the taxpayer had failed to establish a fair market value for the easement, and the Tax Court agreed.[48]

In determining the fair market value of a conservation easement, the "before and after" valuation, which compares the values of the property with and without the easement, is generally accepted.[49] The valuation also takes into consideration "any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use."[50] Both the taxpayer and the IRS relied heavily on expert opinion testimony as to the pre- and post-contribution values of the property. However, the taxpayers' experts were found to be flawed and the Tax Court concluded that the evidence presented by the experts was not entitled to any weight.[51] Contrary to the taxpayer's experts, the IRS's expert determined that due to the historical nature of the neighborhood, there was no negative impact in valuation due to the restrictions of the easement, and, in fact, the "preservation of historic facades is a benefit, not a detriment, to the value of … property."[52] The 2nd Circuit affirmed the Tax Court's finding that the value of the property was unchanged after the taxpayer granted the easement, and therefore, the court further held that the façade easement had no fair market value when conveyed to the National Architectural Trust.[53]

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40 *Mitchell*, 775 F.3d at 1251, 1255.

41 IRC § 170(h)(1); Treas. Reg. § 1.170A-14(g).

42 *Belk*, 774 F.3d at 227.

43 *Mitchell*, 775 F.3d at 1255.

44 IRC § 170(f)(11)(C).

45 755 F.3d 148, 150 (2d Cir. 2014), *aff'g* T.C. Memo. 2013-18.

46 *Id*.

47 The Tax Court initially determined that the appraisal was not a "qualified appraisal" pursuant to Treas. Reg. § 1.170A-13(c)(2)(i)(A), and therefore, the taxpayer was not entitled to a deduction. *See Scheidelman v. Comm'r*, T.C. Memo. 2010-151, *vacated by*, 682 F.3d 189 (2d Cir. 2012), *remanded*, T.C. Memo. 2013-18, *aff'd*, 775 F.3d 148 (2d Cir. 2014).

48 *Scheidelman*, 755 F.3d at 150-51.

49 *Id.* at 152. *See also Hilborn v. Comm'r*, 85 T.C. 677, 688 (1985); Treas. Reg. § 1.170A-14(h)(3)(i).

50 Treas. Reg. § 1.170A-14(h)(3)(ii).

51 *Scheidelman*, 755 F.3d at 152.

52 *Id.* at 153.

53 *Id.* at 153-54.

When using the before and after test to determine the value of an easement placed on property that a taxpayer later claims as a charitable contribution, the property's "highest and best use" is used to determine the property's value before an easement. Many of these "highest and best use" cases, including the U.S. Court of Appeals for the 5th Circuit's decision in *Whitehouse Hotel Limited Partnership v. Commissioner*, involve very complex and specific fact patterns.[54] In *Whitehouse Hotel Limited Partnership*, the taxpayers appealed the Tax Court's conclusion that the "highest and best use" of a historical building was not a luxury hotel or even a non-luxury hotel, but, on the date of the easement, the correct valuation was a "shell building [] …suitable for conversion to [a] hotel."[55] The "highest and best use" of a property is the "reasonable and probable use that supports the highest present value," and the vital question is "what a hypothetical willing buyer would consider in deciding how much to pay for the property."[56] The 5th Circuit affirmed the Tax Court's determination that the "highest and best use" of the easement could be either a luxury hotel or a non-luxury hotel and that the valuation of the easement would not vary as a result of that determination.[57] The "highest and best use" element for valuation is very fact-specific and due to the lack of clear regulations and bright-line interpretations in the case law, subject to frequent and prolonged litigation.[58]

Substantiation

Sixteen cases involved the substantiation of deductions for charitable contributions. When determining whether a claimed charitable contribution deduction is adequately substantiated, courts tend to follow a strict interpretation of IRC § 170. Treasury Regulation § 1.170A–13(a)(1) requires the taxpayer to maintain a canceled check or a receipt from the donee organization to substantiate a cash contribution. In the absence of a canceled check or a receipt from the donee organization, the taxpayer must maintain other reliable written records showing the name of the donee and the date and the amount of the contribution.

In *Anyanwu v. Commissioner*, the taxpayer, who had recently divorced, claimed charitable deductions in the amount of $21,500 for 2006 and $26,600 for 2007, all of which had been disallowed by the IRS.[59] The taxpayer provided copies of canceled checks payable to her church and an "Individual Tithes and Offerings Summary" for 2006 and 2007, showing $24,730 and $26,600 respectively. The summaries stated that the church did not provide any goods or services in exchange for the contributions. Although the summaries did not list the date on which they were prepared, the court found that the summaries were contemporaneous.[60]

Although the taxpayer was divorced in 2005, the summaries of contributions were addressed to both herself and her former husband, Mr. Anyanwu, and the taxpayer admitted to altering the summaries to remove her former husband's name.[61] Despite having altered the summaries, the taxpayer provided canceled checks, which had only the taxpayer's name on them, not her ex-husband, matching the altered summaries.[62] However, the court disallowed five contributions that the taxpayer was not able to substantiate with canceled checks and only allowed $1,000 for one contribution, which was the amount listed on

54 *Whitehouse Hotel Ltd. P'ship v. Comm'r*, 755 F.3d 236 (5th Cir. 2014), *aff'g in part, vacating in part* 130 T.C. 304.
55 *Id.* at 241 (quoting *Whitehouse Hotel Ltd. P'ship v. Comm'r*, 139 T.C. 304, 337 (2012)).
56 *Id.* (quoting *Whitehouse Hotel Ltd. P'ship v. Comm'r*, 615 F.3d 321, 335 (5th Cir. 2010), *remanded to* 130 T.C. 304 (2012)).
57 *Id.* at 244
58 *See id.*; *Whitehouse Hotel Ltd. P'ship*, 615 F.3d at 340.
59 T.C. Memo. 2014-123.
60 *Id.*
61 *Id.*
62 *Id.*

the summary, even though the taxpayer showed a canceled check for $2,800. The Tax Court determined that the taxpayer had successfully substantiated the majority of her contributions and allowed a charitable contribution deduction of $19,700 for 2006 and $26,600 for 2007.[63]

Gifts of charitable contributions of $250 or more must be substantiated by a contemporaneous written acknowledgement from the donee organization that must include:

- The amount of cash and a description (but not value) of any property other than cash contributed;
- Whether the donee organization provided any goods or services in consideration, in whole or in part; and
- A description and good faith estimate of the value of any goods or services or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.[64]

For non-cash gifts of charitable contributions exceeding $500, the taxpayer must also maintain written records that include:

- The approximate date the property was acquired and the manner of its acquisition (*i.e.*, purchase, gift, inheritance, etc.);
- A description of the property in detail reasonable under the circumstances;
- The cost or other basis of the property;
- The fair market value of the property at the time it was contributed; and
- The method used in determining its fair market value.[65]

In *Kunkel v. Commissioner*, the IRS disallowed a charitable contribution deduction of $37,315 for noncash charitable contributions by the taxpayers.[66] The taxpayers claimed to have donated a variety of property to four charitable organizations: the Upper Dublin Lutheran Church, Goodwill Industries, the Military and Order of the Purple Heart Service Foundation (Purple Heart), and Vietnam Veterans of America.[67] The taxpayers claimed a contribution totaling $13,115 in noncash items to their church's 2011 annual flea market; however, they did not produce a receipt or acknowledgement from the church of their donations,[68] nor did they provide any evidence that the church actually received delivery of them. The taxpayers also allegedly contributed $24,200 in noncash donations, including over $20,000 in clothing, to the three additional charitable organizations. Similar to the church donations, the taxpayers did not provide any documentary evidence and could not remember which items went to which organization and when they had donated them.[69] The only evidence the taxpayers provided, other than their own

63 *Anyanwu*, T.C. Memo. 2014-123.

64 IRC §§ 170(f)(8)(A) and (B). The IRS issued a Notice of Proposed Rulemaking on September 17, 2015, that would implement the exception to the "contemporaneous written acknowledgement" requirement for substantiating charitable contribution deductions of $250 or more and would provide rules concerning the time and manner for donee organizations to file information returns that report the requirement information about contributions. *See* Prop. Treas. Reg. § 1.170A-13(f)(18)-(19), 80 Fed. Reg. 55,802 (Sept. 17, 2015).

65 IRC § 170(f)(11)(B); Treas. Reg. §§ 1.170A-13(b)(2)(ii)(C) and (D), (3)(i)(A) and (B).

66 T.C. Memo. 2015-71.

67 *Id*.

68 The taxpayers provided a receipt for their 2012 donations to the flea market; thus, the church was equipped to provide this documentation.

69 *Kunkel*, T.C. Memo. 2015-71.

testimony, was doorknob hangers left by charities stating "thank you for your contribution," but not listing the date, property, or name of contributor.[70]

The taxpayers, who did not provide a "contemporaneous written acknowledgement" from any of the charities, alleged this acknowledgement was not necessary because all of their contributions were under $250.[71] The Tax Court did not find the taxpayer's assertion credible, due to the fact that the taxpayers would have had to make 97 distinct donations all with donations less than $250, despite the fact that the taxpayers testified to assigning the value of donations while completing their tax returns in 2012.[72] The Tax Court also noted that the taxpayers did not maintain written records establishing when or how they acquired items, their cost bases, their condition, and how the fair market value was calculated, nor did the taxpayers furnish a qualified appraisal, all of which is needed for contributions exceeding $500.[73] Although the Tax Court acknowledged that the taxpayers did donate some property during the tax year at issue, the lack of a written contemporaneous acknowledgment and failure to provide evidence as to value, date, location, and condition of goods donated did not satisfy the requirements of IRC § 170, and the entire deduction was disallowed.[74]

CONCLUSION

IRC § 170 and the accompanying Treasury Regulations provide detailed requirements with which taxpayers must strictly comply. The statutory and regulatory requirements to qualify for a deduction become more stringent as deductions increase in size. Most of the charitable contribution cases reviewed this year addressed issues regarding substantiation of contributions or the complex rules governing the donation of a conservation easement. It is vital that taxpayers include all information required by the IRC and regulations to substantiate any charitable contributions and their value. The courts have consistently upheld the regulations and disallowed deductions that do not comply with the statutory and regulatory requirements.

When donating a conservation easement, taxpayers should pay particular attention to the valuation of the easement, ensuring the valuation determination can be adequately supported. Additionally, the cases pertaining to a qualified conservation contribution illustrate the importance of paying close attention to the technicalities of the regulations. Easement deeds should be reviewed for ambiguity, especially as to whether use restrictions have been granted in perpetuity to the donee.

70 *Kunkel*, T.C. Memo. 2015-71. The taxpayers testified that they created index cards noting the items as they were delivered to Goodwill or left for pickup by Purple Heart of Vietnam Veterans. They aggregated this information into a master list and assigned estimated values to the items at the time they prepared their tax returns. However, the taxpayers did not provide any evidence of the index cards nor did they prepare any other contemporaneous records to support their alleged gifts. They also did not provide any evidence regarding their cost bases in items or how they determined the fair market value.

71 *Id.*

72 *Id.*

73 *Id.*

74 *Id.*

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

SUMMARY

From June 1, 2014, through May 31, 2015, the federal courts issued decisions in at least 22 cases involving the Internal Revenue Code (IRC) § 6673 "frivolous issues" penalty and at least four additional cases involving analogous penalties at the appellate level.[1] These penalties are imposed against taxpayers for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.[2] In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future.[3] Nonetheless, we included these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

TAXPAYER RIGHTS IMPACTED[4]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

PRESENT LAW

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.[5] The maximum penalty for taxpayers is $25,000.[6] In some cases, the IRS requests that the Tax Court impose the penalty;[7] in other cases, the Tax Court exercises its discretion, *sua sponte*,[8] to do so.

1 Analogous penalties at the appellate level include those under IRC § 7482 (c)(4), Fed. R. App. P. 38, or other authority.

2 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts may impose the penalty under IRC § 6673(b)(1). U.S. Courts of Appeals generally impose sanctions under IRC § 7482(c)(4), 28 U.S.C. § 1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.

3 *See, e.g.*, *Kaye v. Comm'r*, T.C. Memo. 2014-145.

4 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

5 IRC §§ 6673(a)(1)(A), (B), and (C). Likewise, the Tax Court may impose a penalty under IRC § 6673(a)(2) against any person admitted to practice before the Tax Court for unreasonably and vexatiously multiplying the proceedings in any case.

6 IRC § 6673(a)(1).

7 The standards for the IRS's decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual. *See* CCDM 35.10.2 (Aug. 11, 2004). For sanctions under IRC § 6673(a)(2) of attorneys or other persons admitted to practice before the Tax Court, all requests for sanctions are reviewed by the designated agency sanctions officer (currently the Associate Chief Counsel (Procedure & Administration)). This review ensures uniformity on a national basis. *See, e.g.*, CCDM 35.10.2.2.3 (Aug. 11, 2004).

8 *"Sua sponte"* means without prompting or suggestion; on its own motion. Black's Law Dictionary (10th ed. 2014). Thus, for conduct that it finds particularly offensive, the Tax Court can choose to impose a penalty under IRC § 6673 even if the IRS has not requested the penalty. *See, e.g.*, *Patton v. Comm'r*, T.C. Memo. 2015-75, *appeal docketed*, No. 15-2007 (6th Cir. Aug. 25, 2015).

Taxpayers who institute actions under IRC § 7433[9] for certain unauthorized collection actions can be subject to a maximum penalty of $10,000 if the court determines that the taxpayer's position in the proceedings is frivolous or groundless.[10] In addition, IRC § 7482(c)(4),[11] §§ 1912 and 1927 of Title 28 of the U.S. Code,[12] and Rule 38 of the Federal Rules of Appellate Procedure[13] (among other laws and rules of procedure) authorize federal courts to impose penalties against taxpayers or their representatives for raising frivolous arguments or using litigation tactics primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in non-tax cases, this report focuses primarily on the IRC § 6673 penalty.

ANALYSIS OF LITIGATED CASES

We analyzed 22 opinions issued between June 1, 2014, and May 31, 2015, in which courts addressed the IRC § 6673 penalty. Twenty-one of these opinions were issued by the Tax Court, and one was issued by a U.S. Court of Appeals in a case brought by a taxpayer who sought review of the Tax Court's imposition of the penalty. The Court of Appeals sustained the Tax Court's position. Four additional case decisions were issued by the Courts of Appeals on analogous appellate level penalties under IRC § 7482 (c)(4), FRAP Rule 38, or other authority. Table 9 in Appendix 3 includes all 26 of these opinions in total.

In ten cases, the Tax Court imposed penalties under IRC § 6673, with the amounts ranging from $500 to $25,000. In seven cases before the Tax Court, taxpayers prevailed when the IRS requested a penalty. In each of these cases, the Tax Court warned the taxpayers not to bring similar arguments in the future.[14] Two taxpayers were represented by an attorney; the taxpayers in the remaining 20 cases appeared *pro se* (represented themselves). In at least one case, the Tax Court noted that the *pro se* taxpayer may not be familiar with all the rules and procedures of the court and thus opted to not impose the penalty. But the Tax Court nonetheless made clear that "*Pro se* status, however, isn't a license to litter the dockets of the Federal courts with ridiculous allegations concerning the Code."[15]

The taxpayers presented a wide variety of arguments challenging the U.S. tax system that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts in nine of 22 cases cited the language set forth in *Crain v. Commissioner*:

> We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The

9 IRC § 7433(a) allows a taxpayer a civil cause of action against the United States, if an IRS employee intentionally or recklessly, or by reason of negligence, disregards any IRC provision or Treasury regulation in connection with collecting the taxpayer's federal tax liability.

10 IRC § 6673(b)(1).

11 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court's decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer's position in the appeal was frivolous or groundless.

12 28 U.S.C. § 1912 provides that when the Supreme Court or a United States Court of Appeals affirms a judgment, the court has the discretion to award to the prevailing party just damages for the delay, and single or double costs. 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and vexatiously multiplying proceedings; such person may be required to personally pay the excess costs, expenses, and attorneys' fees reasonably incurred because of his or her conduct.

13 Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.

14 *See, e.g.*, *Bowers v. Comm'r*, T.C. Memo. 2014-130.

15 *Id.*

constitutionality of our income tax system — including the role played within that system by the Internal Revenue Service and the Tax Court — has long been established.[16]

In the Tax Court cases we reviewed, taxpayers raised the following issues that the court deemed frivolous and thus subjected the taxpayers to a penalty under IRC § 6673(a)(1) (or, in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future, if the taxpayers maintained the same positions):

- **Taxes and procedures to collect taxes are unconstitutional:** We only identified one case this year where a taxpayer made an argument that taxes or how they are collected are unconstitutional.[17] Previous years have seen additional taxpayers advance similar arguments to no avail.[18] The taxpayer in the one case who made constitutional arguments this year advanced many facets of the various common constitutional arguments seen in other cases over the years, including the 16th Amendment only authorizes excise taxes, and levies violate both the Fourth and Fifth Amendments. The court found sanctions were appropriate in this case.
- **The IRS lacks proper authority:** Taxpayers in at least four cases argued that the IRS lacked the authority to take the proposed actions.[19] In two of these cases, taxpayers asserted that the employees who issued various notices did not have the proper delegation of authority to authorize the proposed action.[20] The IRS prevailed in two cases,[21] and although the taxpayers prevailed in the remaining two cases, the court warned the taxpayers not to pursue similar arguments in the future.[22]
- **Taxpayers are not United States persons or United States income is not taxable:** Taxpayers in three cases presented arguments that they are not United States persons subject to tax or that United States income is not taxable.[23] In one case, a taxpayer argued that he was a resident of the independent area of Harris County, TX, which is not in the United States.[24] The court imposed a penalty of $8,000 under Rule 38 of the Federal Rules of Appellate Procedure.

CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated year after year that the courts routinely and universally reject.[25] Taxpayers avoided the IRC § 6673 penalty in only seven cases where the IRS requested it, and in each of these cases, the courts warned the taxpayer not to bring similar arguments in the future, demonstrating the willingness of the courts to penalize taxpayers when they offer frivolous arguments or institute a case merely for delay. Moreover, even when the Tax Court

16 *Crain v. Comm'r*, 737 F.2d 1417, 1417-18 (5th Cir. 1984). *See, e.g.*, *Rader v. Comm'r*, 143 T.C. 376 (2014).

17 *Taliaferro v. Freeman*, 595 F. App'x 961 (11th Cir. 2014), *aff'g Taliaferro v. U.S.*, 113 A.F.T.R.2d (RIA) 1840 (M.D. Ga. 2014).

18 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 510-12.

19 *See, e.g.*, *Muncy v. Comm'r*, T.C. Memo. 2014-251, *appeal docketed*, No. 15-1626 (8th Cir. Mar. 26, 2015).

20 *May v. Comm'r*, T.C. Memo. 2014-194; *Muncy v. Comm'r*, T.C. Memo. 2014-251, *appeal docketed*, No. 15-1626 (8th Cir. Mar. 26, 2015).

21 *Banister v. Comm'r*, T.C. Memo. 2015-10, *appeal docketed*, No. 15-71103 (9th Cir. Apr. 9, 2015); *May v. Comm'r*, T.C. Memo. 2014-194.

22 *Bowers v. Comm'r*, T.C. Memo. 2014-130; *Muncy v. Comm'r*, T.C. Memo. 2014-251, *appeal docketed*, No. 15-1626 (8th Cir. Mar. 26, 2015).

23 *See, e.g.*, *U.S. v. Trowbridge*, 591 F. App'x 298 (5th Cir. 2015), *aff'g* Docket No. 4:14-CV-00027 (S.D. Tex. May 22, 2014), *cert. denied*, 135 S.Ct. 2816 (June 8, 2015); *Bennett v. Comm'r*, T.C. Memo. 2014-256, *appeal docketed*, No. 15-71228 (9th Cir. Apr. 21, 2015); *Banister v. Comm'r*, T.C. Memo. 2015-10, *appeal docketed*, No. 15-71103 (9th Cir. Apr. 9, 2015).

24 *U.S. v. Trowbridge*, 591 F. App'x 298 (5th Cir. 2015), *aff'g* Docket No. 4:14-CV-00027 (S.D. Tex. May 22, 2014), *cert. denied*, 135 S.Ct. 2816 (June 8, 2015).

25 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 510-12.

acknowledges that a penalty will likely not dissuade the taxpayer from raising frivolous arguments in the future, the Tax Court nonetheless recognizes that "serious sanctions also serve to warn other taxpayers to avoid pursuing similar tactics."[26] Further, when the IRS has not requested the penalty, the court may nonetheless raise the issue *sua sponte*, and in all cases identified, either imposed the penalty or cautioned the taxpayer that similar future behavior will result in a penalty.[27]

26 *Bennett v. Comm'r*, T.C. Memo. 2014-256, *appeal docketed*, No. 15-71228 (9th Cir. Apr. 21, 2015). *See also Banister v. Comm'r*, T.C. Memo. 2015-10, *appeal docketed*, No. 15-71103 (9th Cir. Apr. 9, 2015).

27 *See, e.g.*, *Kaye v. Comm'r*, T.C. Memo. 2014-145 (court raised the issue *sua sponte* and warned the taxpayer not to assert similar arguments in the future).

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

SUMMARY

Married couples may elect to file their federal income tax returns jointly or separately. Spouses filing joint returns are jointly and severally liable for any deficiency or tax due.[1] Joint and several liability permits the IRS to collect the entire amount due from either taxpayer.[2]

Internal Revenue Code (IRC) § 6015 provides three avenues for relief from joint and several liability. IRC § 6015(b) provides "traditional" relief for deficiencies. IRC § 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. IRC § 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.

TAXPAYER RIGHTS IMPACTED[3]

- *The Right to Pay No More Than The Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

PRESENT LAW

Traditional Innocent Spouse Relief Under IRC § 6015(b)

IRC § 6015(b) provides that a requesting spouse shall be partially or fully relieved from joint and several liability, pursuant to procedures established by the Secretary, if the requesting spouse can demonstrate that:

1. A joint return was filed;
2. There was an understatement of tax attributable to erroneous items of the nonrequesting spouse;[4]

1 IRC § 6013(d)(3). We use the terms "deficiency" and "understatement" interchangeably for purposes of this discussion and the case table in Appendix 3, even though IRC §§ 6015(b)(1)(D) and 6015(f) expressly use the term "deficiency" and IRC § 6015(b)(1)(B) refers to an "understatement of tax."

2 The National Taxpayer Advocate, in the 2005 Annual Report to Congress, proposed legislation that would eliminate joint and several liability for joint filers. *See* National Taxpayer Advocate 2005 Annual Report to Congress 407.

3 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

4 An erroneous item is any income, deduction, credit, or basis that is omitted from or incorrectly reported on the joint return. *See* Treas. Reg. § 1.6015-1(h)(4).

3. The requesting spouse did not know or have reason to know of the understatement, upon signing the return;
4. It is inequitable to hold the requesting spouse liable, taking into account all the facts and circumstances; and
5. The requesting spouse elected relief within two years after the IRS began collection activities against him or her.[5]

A requesting spouse is eligible for a refund under this subsection, so long as the requesting spouse made the payment and the requirements of IRC § 6511 have been met.[6]

Allocation of Liability Under IRC § 6015(c)

IRC § 6015(c) provides that the requesting spouse shall be relieved from liability for deficiencies allocable to the nonrequesting spouse, pursuant to procedures established by the Secretary. To obtain relief under this section, the requesting spouse must demonstrate that:

1. A joint return was filed;
2. The joint filers were unmarried, legally separated, widowed, or had not lived in the same household for the 12 months immediately preceding the election at the time relief was elected; and
3. The election was made within two years after the IRS began collection activities with respect to the requesting spouse.

This election allocates the portion of the deficiency attributable to each joint filer as calculated under the allocation provisions of IRC § 6015(d). A taxpayer is ineligible to make an election under IRC § 6015(c) if the IRS demonstrates that, at the time he or she signed the return, the requesting taxpayer had "actual knowledge" of any item giving rise to the deficiency.[7] Relief is not available for amounts attributable to fraud, fraudulent schemes, or certain transfers of disqualified assets.[8] Finally, no credit or refund is allowed as a result of relief granted under IRC § 6015(c).[9]

Equitable Relief Under IRC § 6015(f)

IRC § 6015(f) provides that the Secretary may relieve a taxpayer from liability for both deficiencies and underpayments[10] where the taxpayer demonstrates that:

1. Relief under IRC § 6015(b) or (c) is unavailable; and
2. It would be inequitable to hold the taxpayer liable for the underpayment or deficiency, taking into account all the facts and circumstances.

5 Not all actions that involve collection will trigger the two-year period of limitations. Under the regulations, only the following four events constitute "collection activity" that will start the two-year period: (1) an IRC § 6330 notice; (2) an offset of an overpayment of the requesting spouse against the joint income tax liability under IRC § 6402; (3) the filing of a suit by the United States against the requesting spouse for the collection of the joint tax liability; and (4) the filing of a claim by the United States to collect the joint tax liability in a court proceeding in which the requesting spouse is a party or which involves property of the requesting spouse. Treas. Reg. § 1.6015-5(b)(2).

6 IRC § 6015(g)(1). *See infra* note 18 for an explanation of the general time period for filing refund claims under IRC § 6511.

7 IRC § 6015(c)(3)(C).

8 IRC §§ 6015(c)(4), (d)(3)(C).

9 IRC § 6015(g)(3).

10 An underpayment of tax occurs when the tax is properly shown on the return but is not paid. *Washington v. Comm'r*, 120 T.C. 137, 158-59 (2003).

Previously, the IRS incorporated the statutory two-year deadline found in IRC §§ 6015 (b)(1)(E) and (c)(3)(B) into the IRC § 6015 regulations and thereby imposed the two-year rule on requests for equitable relief under IRC § 6015(f).[11] In 2009, the Tax Court, in *Lantz v. Commissioner*, held the regulation imposing the two-year rule invalid.[12] The IRS appealed *Lantz* and similar decisions, and three courts of appeals ultimately held that the regulation was valid.[13] In the meantime, the Tax Court continued, where permitted, to hold the regulation invalid, and the issue was appealed to other courts of appeals.[14] The National Taxpayer Advocate consistently advocated for removal of the two-year rule that prevented taxpayers from obtaining equitable relief.[15] In July 2011, the IRS changed its position and now considers requests for equitable relief under IRC § 6015(f) without regard to when the first collection activity was taken.[16] The IRS proposed regulations to codify the change in the two-year rule on August 13, 2013.[17] Taxpayers may now file requests for equitable relief within the period of limitation on collection in IRC § 6502[18] or, for any credit or refund of tax, within the period of limitation in IRC § 6511.[19]

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11 Treas. Reg. §1.6015-5(b)(1).

12 132 T.C. 131 (2009).

13 *Mannella v. Comm'r*, 631 F.3d 115 (3d Cir. 2011) *rev'g and remanding* 132 T.C. 196 (2009); *Jones v. Comm'r*, 642 F.3d 459 (4th Cir. 2011), *rev'g and remanding* T.C. Docket No. 17359-08 (May 28, 2010); *Lantz v. Comm'r*, 607 F.3d 479 (7th Cir. 2010) *rev'g and remanding* 132 T. C. 131 (2009).

14 Adhering to the rule in *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd* 445 F.2d 985 (10th Cir. 1971), that the Tax Court will defer to a Courts of Appeals decision which is squarely on point where appeal from the Tax Court decision lies to that Court of Appeal, the Tax Court continued to hold the regulation invalid in cases appealable to other circuits. *See, e.g.*, *Young v. Comm'r*, T.C. Docket No. 12718-09 (May 12, 2011); *Pullins v. Comm'r*, 136 T.C. 432 (2011); *Stephenson v. Comm'r*, T.C. Memo. 2011-16; *Hall v. Comm'r*, 135 T.C. 374, *appeal dismissed* (6th Cir. Aug. 2, 2011); *Buckner v. Comm'r*, T.C. Docket No. 12153-09, *appeal dismissed* (6th Cir. July 27, 2011); *Carlile v. Comm'r*, T.C. Docket No. 11567-09, *appeal dismissed* (9th Cir. Dec. 8, 2010); *Payne v. Comm'r*, T.C. Docket No. 10768-09, *appeal dismissed* (9th Cir. July 25, 2011); *Coulter v. Comm'r*, T.C. Docket No. 1003-09, *appeal dismissed* (2d Cir. Aug. 4, 2011).

15 National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 1-12 (*Unlimit Innocent Spouse Equitable Relief*); National Taxpayer Advocate 2006 Annual Report to Congress 540 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief under IRC § 6015 or 66*).

16 Notice 2011-70, 2011-2 C.B. 135 (July 25, 2011), *available at* http://www.irs.gov/pub/irs-drop/n-11-70.pdf. The notice provides transitional rules and applies to requests submitted on or after July 25, 2011. The notice also states that pending litigation will be managed consistently with the removal of the two-year rule. *See also* CC-Notice 2011-017 (July 25, 2011) (providing direction for Chief Counsel attorneys handling cases docketed with the Tax Court that involve the two-year deadline).

17 78 Fed. Reg. 49,242 (Aug. 13, 2013). Written or electronic comments were invited. Comments and requests for a public hearing were to be received by November 12, 2013. As of the date of this report, the IRS has not promulgated a final regulation.

18 The statutory period of limitations on collection is generally ten years after the date the tax is assessed. IRC § 6502(a). However, a variety of statutory provisions may extend or suspend the collection period. For example, if a court proceeding to collect the tax is brought, such as a suit to reduce a tax liability to judgment, the period of limitations on collection is extended. Therefore, the period of limitations on collection could exceed ten years, and a claim for innocent spouse relief would be valid at any point during that time.

19 Generally, taxpayers must request a refund within three years from the date their return was filed or two years from the time the tax was paid, whichever occurs later, or, if no return was filed, within two years from the time the tax was paid. IRC § 6511(a). If taxpayers meet the three-year requirement, they can recover payments made during the three-year period that precedes the date of the refund request, plus the period of any extension of time for filing the return. However, taxpayers who do not meet the three-year requirement can recover only payments made during the two-year period preceding the date of the refund request. IRC § 6511(b)(2). Senator Cardin and Representative Becerra introduced companion bills that include the National Taxpayer Advocate's recommendation to codify the removal of the two-year rule that prevented taxpayers from obtaining equitable relief. S. 2333, 114th Cong. (2015) and H.R. 4128, 114th Cong. (2015).

Revenue Procedure 2013-34 provides a nonexclusive list of factors that the IRS considers when determining whether equitable relief is appropriate.[20] Factors include:

- Marital status;
- Economic hardship;
- Knowledge or reason to know of the understatement or underpayment, including abuse by the nonrequesting spouse;
- Legal obligation to pay the outstanding tax liability;
- Significant benefit from the understatement or underpayment;
- Compliance with income tax laws; and
- Mental or physical health.[21]

Rights of the Nonrequesting Spouse

The individual with whom the requesting spouse filed the joint return is generally referred to as a "nonrequesting spouse" and is granted certain rights by IRC § 6015. The nonrequesting spouse must be notified and given an opportunity to participate in any administrative proceedings concerning a claim under IRC § 6015.[22] Further, if during the administrative process, full or partial relief is granted to the requesting spouse, the nonrequesting spouse can file a protest and receive an administrative conference in the IRS Appeals function.[23] The nonrequesting spouse does not have the right to petition the Tax Court in response to the IRS's administrative determination regarding IRC § 6015 relief.[24] If the requesting spouse files a Tax Court petition, the nonrequesting spouse must receive notice of the Tax Court proceeding, and the nonrequesting spouse has an unconditional right to intervene in the proceeding to dispute or support the requesting spouse's claim for relief.[25] However, an intervening spouse has no standing to appeal the Tax Court's decision to the United States Courts of Appeals.[26]

Judicial Review

Taxpayers seeking relief under IRC § 6015 generally file Form 8857, *Request for Innocent Spouse Relief*.[27] After reviewing the request, the IRS ultimately issues a final notice of determination granting or denying relief in whole or in part.[28] The taxpayer has 90 days from the date the IRS mails the notice to file a petition with the Tax Court.[29] The Tax Relief and Health Care Act of 2006 amended IRC § 6015(e)

20 Rev. Proc. 2013-34, 2013-43 I.R.B. 397. Revenue Procedure 2013-34 superseded Revenue Procedure 2003-61, 2003-2 C.B. 296.

21 *Id*. at 400-03.

22 IRC § 6015(h)(2).

23 Rev. Proc. 2003-19, 2003-5 C.B. 371.

24 *Maier v. Comm'r*, 119 T.C. 267 (2002), *aff'd*, 360 F.3d 361 (2d Cir. 2004) (holding that there are no provisions in IRC § 6015 that allow the nonrequesting spouse to petition the Tax Court from a notice of determination).

25 *Van Arsdalen v. Comm'r*, 123 T.C. 135 (2004).

26 *Baranowicz v. Comm'r*, 432 F.3d 972 (9th Cir. 2005).

27 *See* IRS Form 8857, *Request for Innocent Spouse Relief, Instructions* (Sept. 2010).

28 There are several types of preliminary determination letters that the IRS may send to the requesting or nonrequesting spouse before issuing a final determination.

29 IRC § 6015(e)(1)(A)(ii).

to expressly provide that the Tax Court has jurisdiction in "stand-alone" cases to review IRC § 6015(f) determinations, even where no deficiency has been asserted.[30]

ANALYSIS OF LITIGATED CASES

We identified 24 opinions issued between June 1, 2014, and May 31, 2015. The Tax Court issued the majority of the opinions (20 opinions, or 83 percent). The IRS prevailed in full in 15 cases (63 percent), while the requesting spouse prevailed in seven cases (29 percent). Two cases had split decisions (eight percent). Taxpayers had representation in 13 cases (54 percent) and appeared *pro se* (*i.e.*, they represented themselves) in the remaining 11 cases (46 percent). *Pro se* taxpayers prevailed in full in four cases (36 percent), while one *pro se* taxpayer obtained a split decision. The nonrequesting spouse intervened in ten cases (42 percent).

Procedural Issues

Of the 24 cases, five presented procedural issues. Courts were faced with issues such as whether a requesting spouse may voluntarily withdraw a petition to review the IRS's denial of relief from joint liability and whether district and bankruptcy courts have jurisdiction over petitions for equitable relief filed under IRC § 6015(f).

In *Davidson v. Commissioner*, the Tax Court examined its authority to dismiss a request for relief without entering a decision in a "stand-alone" case.[31] After the IRS denied her request for innocent spouse relief, Ms. Davidson petitioned the Tax Court for redetermination.[32] However, after the IRS submitted its answer, Ms. Davidson requested to voluntarily withdraw her petition, to which the IRS did not object.[33] The court first distinguished dismissals in deficiency cases, where IRC § 7459(d) controls, with other controversies. In deficiency cases, which comprise the majority of cases before the Tax Court, a taxpayer "may not withdraw a petition to avoid a decision."[34] Should the Tax Court dismiss a deficiency proceeding, the effect is a decision for the IRS, unless the dismissal is for lack of jurisdiction.[35] In *Davidson*, a non-deficiency case, the Tax Court looked to the Federal Rules of Civil Procedure (FRCP) for guidance, since IRC § 7459(d) did not apply.[36]

30 Pub. L. No. 109-432, Div. C, § 408(a), (c), 120 Stat. 2922, 3061-62 (2006). Prior to amendment, IRC § 6015(e) provided for Tax Court review of determinations under IRC §§ 6015(b) or (c), but it was not clear that the Tax Court had jurisdiction to review requests for relief made only under IRC § 6015(f) when no deficiency had been asserted. The 2006 amendment followed the National Taxpayer Advocate's recommendation that IRC § 6015(e) be amended to clarify that taxpayers have the right to petition the Tax Court for review of determinations made only under IRC § 6015(f). *See* National Taxpayer Advocate 2001 Annual Report to Congress 159-65 (Key Legislative Recommendation: *Joint and Several Liability Final Determination Rights*). The filing of a Tax Court petition in response to the final notice of determination or after the IRC § 6015 claim is pending for six months is often referred to as a "standalone" proceeding, because jurisdiction is predicated on IRC § 6015(e) and not deficiency jurisdiction under IRC § 6213.

31 *Davidson v. Comm'r*, 144 T.C. No. 13 (2015). A "stand-alone" case refers to a petition for redetermination that is independent of a deficiency proceeding.

32 *Id*.

33 *Id*.

34 *Id*.

35 *Id*. *See also* IRC § 7459(d). If a petition for redetermination of a deficiency has been filed by the taxpayer, a decision of the Tax Court dismissing the proceeding shall be considered as its decision that the deficiency is the amount determined by the Secretary.

36 *Id*.

Rule 41 of the FRCP allows for voluntary dismissal by the plaintiff under certain circumstances; otherwise the voluntary dismissal must be by court order.[37] A court must use its discretion to "weigh the relevant equities and do justice between the parties."[38] The Tax Court distinguished the present case from *Vetrano v. Commissioner*, a decision in which the Tax Court did not have authority to grant a request to withdraw a request for innocent spouse relief.[39] In *Vetrano*, the taxpayer requested innocent spouse relief as an affirmative defense in a petition to redetermine a deficiency, which is one of three ways a taxpayer may invoke innocent spouse relief.[40] The Tax Court held that the taxpayer was liable for the deficiency but reserved judgment on the relief issue. The taxpayer sought to withdraw her request for relief without prejudice; however, the Tax Court could not grant the request to dismiss because "the court's final decision is conclusive with respect to an individual's later claim for § 6015 relief."[41]

In contrast, the requesting spouse in *Davidson* raised the issue of relief in a separate petition and not as a defense to a deficiency proceeding.[42] The Tax Court held that the *res judicata* provisions in IRC § 6015 are only applicable when there is a prior proceeding.[43] Since there is no prior proceeding when relief is requested in a "stand-alone" case, the Tax Court found that it has authority to dismiss a "stand-alone" case if there are no objections by the other party.[44]

In *United States v. Hirsch*, the District Court for the Eastern District of New York considered whether the taxpayer, Ms. Hirsch, was barred from raising innocent spouse relief as a defense in a suit to reduce assessment to judgment.[45] Prior to the suit being commenced, in September 2000, Ms. Hirsch had filed a request for innocent spouse relief with the IRS. The IRS contended it sent a notice of determination denying the request for innocent spouse relief to Ms. Hirsch in July 2003.[46] Ms. Hirsch did not petition the Tax Court for review of the IRS's determination. On March 5, 2010, the United States initiated a civil action to obtain a judgment against Ms. Hirsch, who appeared *pro se*, for her unpaid joint income tax liabilities for 1992 through 1997.[47] Subsequently, on October 20, 2013, the government filed a motion for summary judgment arguing judgment should be entered in its favor. Ms. Hirsch objected to the motion arguing that she should be relieved of the liabilities because she was an innocent spouse. Ms. Hirsch contended that she never received a determination with respect to her request for innocent spouse relief,

37 Fed. R. Civ. P. 41(a). A plaintiff may voluntarily dismiss an action without a court order by filing (i) a notice of dismissal before the opposing party serves either an answer or a motion for summary judgment; or (ii) a stipulation of dismissal signed by all parties who have appeared.

38 *Davidson v. Comm'r*, 144 T.C. No. 13 (2015) (quoting *McCants v. Ford Motor Co.*, 781 F.2d 855, 857 (11th Cir. 1986)).

39 *Vetrano v. Comm'r*, 116 T.C. 272 (2001).

40 *Davidson v. Comm'r*, 144 T.C. No. 13 (2015). The Tax Court has jurisdiction to review a taxpayer's request for innocent spouse relief in only three circumstances: (1) where a stand-alone petition is filed pursuant to IRC § 6015(e)(1)(A); (2) where a petition for review of a lien or levy action is filed pursuant to collection due process provisions of IRC §§ 6230 or 6330; and (3) as an affirmative defense where a petition for redetermination of a deficiency is filed pursuant to IRC § 6213(a). *See Maier v. Comm'r*, 119 T.C. 267, 270-71 (2002), *aff'd*, 360 F.3d 361 (2d Cir. 2004); *Butler v. Comm'r*, 114 T.C. 276, 287-89 (2000); IRC §§ 6015(e)(1)(A), 6320(c), and 6330(c)(2)(A)(i). A "stand-alone" petition must be filed no later than the close of the 90th day after the Commissioner has issued a final determination. IRC § 6015(e)(1)(A)(i).

41 *Davidson v. Comm'r*, 144 T.C. No. 13 (2015). *See also* IRC § 6015(g)(2) (*res judicata*).

42 *Davidson v. Comm'r*, 144 T.C. No. 13 (2015).

43 *Id*.

44 *Id*.

45 114 A.F.T.R.2d (RIA) 5896 (2014). The factual background of this case is convoluted as it involves a divorce proceeding and a subsequent bankruptcy of Ms. Hirsch's husband.

46 *U.S. v. Hirsch*, 114 A.F.T.R.2d (RIA) 5896 (E.D.N.Y. 2014). The taxpayer claims that she never received the notice of determination, but she did file an administrative appeal to the IRS appeals office prior to the final denial in July 2003.

47 *Id*.

and the parties disputed whether the notice of determination was in fact sent to Ms. Hirsch's last known address as required by law.[48]

The court denied the motion for summary judgment concluding that the government did not establish that the Tax Court had jurisdiction over Ms. Hirsch's non-deficiency, stand-alone innocent spouse claim under IRC § 6015(f). Currently, IRC § 6015(e)(1) gives the Tax Court jurisdiction to hear IRC § 6015(f) claims;[49] however, that provision took effect on December 20, 2006 and only applies to tax liabilities that arise or are unpaid on or after that date.[50] Prior to the 2006 amendment, courts were unsure whether the Tax Court had jurisdiction to review "nondeficiency stand-alone petitions."[51] In 2002, the Tax Court held it had jurisdiction in these cases.[52] In 2004, however, the 2nd Circuit expressed doubt regarding whether the Tax Court had jurisdiction. In subsequent decisions, the 9th Circuit, 8th Circuit, and Tax Court held that the Tax Court lacked jurisdiction to hear IRC § 6015(f) appeals absent express statutory language.[53] Because Ms. Hirsch's tax liabilities arose before December 20, 2006, the court stated: "it appears that the Tax Court lacked jurisdiction to review [her innocent spouse] application."[54] The court also denied the motion because a question of material fact existed as to whether IRS actually mailed the notice of determination denying Ms. Hirsch's innocent spouse application to her last known address. This opinion is important because the decision leaves open the possibility that this district court might allow the taxpayer to raise IRC § 6015(f) as an affirmative defense in a suit to reduce an assessment to judgment, and that the Tax Court may not have exclusive jurisdiction.[55] It has been a longstanding position of the National Taxpayer Advocate that taxpayers should be able to raise innocent spouse claims as an affirmative defense in an action to reduce joint federal tax assessments to judgment or in a lien foreclosure suit.[56]

In *Nunez v. Commissioner*, the 9th Circuit addressed whether the Tax Court maintains its jurisdiction when the IRS, in a change of its position, no longer opposes a request for innocent spouse relief. Ms. Nunez petitioned the Tax Court after the IRS denied her request for relief; however, before trial, the IRS changed its position and would not oppose a ruling in favor of the taxpayer.[57] Nevertheless, the Tax Court denied her motion, and the taxpayer appealed the Tax Court's denial of her motion to vacate its

48 The notice of determination must be sent to the taxpayer's last known address. IRC § 6015(e)(1)(A)(i)(I). Generally, a taxpayer's last known address is the address on the taxpayer's most recent return unless the IRS has been given clear and concise notification of a different address. Treas. Reg. § 301.6212-2(a).

49 The parties agreed that since there was no understatement, Ms. Hirsch's claim had to be under IRC § 6015(f).

50 *U.S. v. Hirsch*, 114 A.F.T.R.2d (RIA) 5896 (E.D.N.Y. 2014).

51 *Id*.

52 *See Ewing v. Comm'r*, 118 T.C. 494 (2002), *rev'd* 439 F.3d 1009 (9th Cir. 2006).

53 *See Comm'r v. Ewing*, 439 F.3d 1009 (9th Cir. 2006); *Bartman v. Comm'r*, 446 F.3d 484 (8th Cir. 2006). Upon reconsideration, the Tax Court overruled its holding in the *Ewing* case. *See Billings v. Comm'r*, 127 T.C. 7 (2006). The previous version of IRC § 6015(e) expressly granted the Tax Court jurisdiction only in IRC § 6015(b) and (c) cases. Congress amended IRC § 6015(e) in 2006 to expressly grant authorization in IRC § 6015(f) cases.

54 *U.S. v. Hirsch*, 114 A.F.T.R.2d (RIA) 5896 (E.D.N.Y. 2014). Although the court was correct in its analysis, prior to 2006, the Tax Court routinely reviewed stand-alone IRC § 6015(f) claims and made determinations on them.

55 The statute permits a taxpayer to petition the Tax Court "in addition to any other remedy provided by law." Thus, U.S. district courts and the Tax Court may have concurrent jurisdiction. IRC § 6015(e)(1)(A). However, the United States has argued that a taxpayer cannot raise innocent spouse as an affirmative defense in a district court or bankruptcy court action on jurisdictional grounds and prevailed in a number of cases. *See, e.g.*, *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (2012); *U.S. v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (2007); *U.S. v. Feda*, 97 A.F.T.R.2d 1985 (2006); *In re Mikels*, 524 B.R. 805, 807 (Bankr. S.D. Ind. 2015).

56 *See, e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress 415-16. *See also* National Taxpayer Advocate 2012 Annual Report to Congress 648; National Taxpayer Advocate 2010 Annual Report to Congress 504; National Taxpayer Advocate 2009 Annual Report to Congress 487; National Taxpayer Advocate 2008 Annual Report to Congress 524; National Taxpayer Advocate 2007 Annual Report to Congress 631.

57 *Nunez v. Comm'r*, 599 F. App'x 629 (9th Cir. 2015), *aff'g* T.C. Docket No. 15168-10 (Feb. 15, 2013).

decision.[58] The taxpayer argued that because the IRS did not oppose granting her relief, the Tax Court lost jurisdiction.[59] The 9th Circuit affirmed the Tax Court, holding that "nothing in § 6015 provides that the Tax Court loses jurisdiction once the Commissioner changes his position and supports, or stops opposing, a grant of relief in the requesting or electing spouse's favor."[60] The Tax Court loses jurisdiction only in the case where either spouse files a refund suit in a district court, which did not happen in this instance.[61] As a result, Ms. Nunez was not entitled to relief from joint and several liability for the tax years in dispute.[62]

In *In re Mikels*, the Bankruptcy Court for the Southern District of Indiana concluded that it lacks jurisdiction to make a determination of innocent spouse relief under IRC § 6015(f). In response to deficiencies assessed for the 2008 and 2009 tax years, Mr. Mikels filed for innocent spouse relief for several tax years.[63] The IRS granted relief for 2008 and 2009 but denied relief for the other tax years.[64] The IRS later abated tax liabilities for 2008 and 2009; however, Mr. Mikels filed an objection to the IRS's determinations for tax years 2003-05, 2007, and 2010, claiming that he was entitled to relief under either IRC § 6015(c) or (f), since the liability was related to his ex-wife's daycare business.[65] The court concluded that IRC § 6015(c) did not apply, since the only deficiencies that were assessed were subsequently abated, rendering the issue of innocent spouse relief under IRC § 6015(c) moot. For Mr. Mikels' IRC § 6015(f) relief for the remaining tax years, the court acknowledged that section "[6015(e)(1)] does not address whether the Tax Court's jurisdiction is exclusive;" however, the court followed district court precedent concluding that the Tax Court has exclusive jurisdiction regarding stand-alone petitions for innocent spouse relief.[66]

In the 2013 Annual Report to Congress, the National Taxpayer Advocate stated that nothing in the language of IRC § 6015 gives the Tax Court exclusive jurisdiction to determine innocent spouse claims.[67] Instead, the language of IRC § 6015(e) permits a taxpayer to petition the Tax Court for relief "in addition to any other remedy provided by law."[68] The view taken by the bankruptcy court and district courts may leave taxpayers without a forum in which to raise innocent spouse relief as a defense to a collection suit. The National Taxpayer Advocate has made legislative recommendations to clarify this issue.[69]

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58 *Nunez v. Comm'r*, 599 F. App'x 629 (9th Cir. 2015), *aff'g* T.C. Docket No. 15168-10 (Feb. 15, 2013).

59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.*

63 *In re Mikels*, 524 B.R. 805 (Bankr. S.D. Ind. 2015). Mr. Mikels sought innocent spouse relief for the 2003-2005, 2007-2009, and 2010 tax years. Mr. Mikel filed late joint returns for the years 2003-2005, 2007, and 2010 and did not file returns for the years 2008 and 2009.

64 *Id.*

65 *Id.*

66 *Id.* (citing *U.S. v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007)).

67 National Taxpayer Advocate 2013 Annual Report to Congress 408-19.

68 IRC § 6015(e).

69 The National Taxpayer Advocate has recommended that Congress address this issue in three Annual Reports to Congress. National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*); National Taxpayer Advocate 2009 Annual Report to Congress 378 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*); National Taxpayer Advocate 2007 Annual Report to Congress 549 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*).

Relief on the Merits

Nineteen cases were decided on the merits. Taxpayers received full relief in five cases and partial relief in two cases. Two issues were frequently discussed in these decisions: (1) whether the requesting spouse knew or had reason to know of the underpayment, and (2) the nonrequesting spouse's right to intervene to support or oppose relief. First, the requesting spouse's knowledge that there was a deficiency or that the nonrequesting spouse would not pay the tax was a factor in 15 of the 19 decisions, including all seven of the decisions where taxpayers received full or partial relief.[70] Second, the nonrequesting spouse intervened to oppose relief in ten of the 19 cases. Of these ten cases, the IRS either originally granted relief or changed its position and determined relief was appropriate before trial in five instances.

The Tax Court reviewed both of these themes in *Molinet v. Commissioner* and *Varela v. Commissioner*. In *Molinet*, Ms. Molinet, a Cuban born taxpayer who did not have a good understanding of the United States banking system yet shared a joint bank account with her spouse who handled all of their finances, requested innocent spouse relief after her former spouse failed to pay taxes on a 401(k) distribution.[71] The IRS initially denied the request for relief but conceded the issue at trial; however, the former spouse intervened and opposed the request for relief.[72] The Tax Court reviewed Ms. Molinet's request for relief under the equitable relief provision in IRC § 6015(f) and examined her knowledge or reason to know of the underpayment as a factor in its analysis.

The Tax Court listed four factors it considered in determining whether the requesting spouse had reason to know of the underpayment:

1. The requesting spouse's level of education;
2. The requesting spouse's degree of involvement in the activity leading to the tax liability;
3. The requesting spouse's involvement in business and household financial matters; and
4. The requesting spouse's business or financial expertise.[73]

The Court found that Ms. Molinet did not have reason to know of the underpayment for three reasons. First, she had "minimal input" in financial decisions because of her difficulty understanding the United States banking system.[74] Second, she did not agree with her former spouse's decision to take taxable distributions from his 401(k) account but "reluctantly signed" the required forms because she "did not feel she had a choice in the matter."[75] Third, she "reasonably believed that she and [her former spouse] did not have any financial problems and that [her former spouse] could pay the tax due."[76] After weighing these factors in Ms. Molinet's favor, the Tax Court found that she was entitled to relief.[77]

70 All three methods of relief under IRC § 6015 contain a knowledge element. Knowledge may be actual or constructive, and the absence of knowledge weighs in favor of relief. *See* IRC §§ 6015(b)(1)(C), 6015(c)(3)(C); Rev. Proc. 2003-61, 2003-2 C.B. 296, §§ 4.02(1)(b) and 4.03(2)(a)(iii); *see also* Notice 2012-8, §§ 4.02(3) and 4.03(2)(c), 2012-4 C.B. 309.

71 *Molinet v. Comm'r*, T.C. Memo 2014-109. The IRS debt was assigned to Ms. Molinet's former spouse in their divorce settlement, and Ms. Molinet was convinced her former spouse could pay the debt.

72 *Id*.

73 *Id*. (citing Rev. Proc. 2013-34, § 4.03(2)(c)(iii), 2013-43 I.R.B. at 402).

74 *Id*.

75 *Id*.

76 *Id*.

77 *Id*.

In *Varela*, Ms. Varela petitioned for innocent spouse relief under all three provisions, and the government agreed at trial that she was entitled to full relief under IRC § 6015(b).[78] In 2003, Ms. Valera began an action to divorce her husband but discontinued the action before it was completed. Following that action, however, Ms. Varela and her former spouse separated their financial assets and responsibilities. Ms. Varela and her former spouse separated in 2009 and eventually divorced in 2012. The IRS agreed that Ms. Varela was entitled to relief, but her former spouse objected. The Tax Court found that Ms. Varela did not have knowledge or reason to know of the understatements because she did not have access to her former spouse's or the corporation's bank accounts since they separated their finances.

CONCLUSION

While the overall number of cases decreased from 2013, the last time innocent spouse relief appeared as a Most Litigated Issue, jurisdiction over innocent spouse relief continues to be an issue. Based on their interpretation of IRC § 6015(e), courts have determined that the Tax Court has exclusive jurisdiction over stand-alone claims for innocent spouse relief, when in fact the statute permits a taxpayer to petition the Tax Court "in addition to any other remedy provided by law."[79] Greater clarity in the statutory language would likely prevent future litigation over jurisdiction and provide taxpayers additional forums in which to pursue their claims. For this reason, the National Taxpayer Advocate has made three legislative recommendations to address this issue and reiterates her position that taxpayers should be able to raise innocent spouse relief as a defense in collection actions.[80]

Courts' interpretation of IRC § 6015(e) prevents innocent spouses from claiming relief in deficiency cases in any forum other than Tax Court, thus limiting their opportunity to challenge and obtain relief from tax liabilities. These restrictions impact the taxpayer's *right to challenge the IRS's position and be heard*, *to pay no more than the correct amount of tax*, *to appeal an IRS decision in an independent forum*, and *to a fair and just tax system*.

78 *Varela v. Comm'r*, T.C. Memo 2014-222.

79 See IRC § 6015(e)(1)(A). This is consistent with the National Taxpayer Advocate's position that nothing in the language of IRC § 6015 confers exclusive jurisdiction the Tax Court for innocent spouse claims. *See* National Taxpayer Advocate 2013 Annual Report to Congress 408-19.

80 The National Taxpayer Advocate has recommended that Congress address this problem in three Annual Reports to Congress. National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*); National Taxpayer Advocate 2009 Annual Report to Congress 378 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*); National Taxpayer Advocate 2007 Annual Report to Congress 549 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*).

TAS CASE ADVOCACY

OFFICE OF THE TAXPAYER ADVOCATE

The National Taxpayer Advocate leads TAS in all aspects of its statutory mission. Under Internal Revenue Code (IRC) § 7803(c)(2)(A), the Office of the Taxpayer Advocate has four principal functions:

- Assist taxpayers in resolving problems with the IRS;
- Identify areas in which taxpayers are experiencing problems with the IRS;
- Propose changes in the administrative practices of the IRS to mitigate problems taxpayers are experiencing with the IRS; and
- Identify potential legislative changes that may be appropriate to mitigate such problems.

The first function described in the statute relates to TAS's case advocacy, which involves assisting taxpayers with their cases. This section of the report discusses how TAS fulfills its mission to assist taxpayers with their specific issues and concerns involving IRS systems and procedures.

TAS's other three functions involve identifying and proposing changes to systemic problems affecting taxpayers. TAS employees advocate systemically by:

- Identifying IRS procedures that adversely affect taxpayer rights or create taxpayer burden; and
- Recommending solutions, either administrative or legislative, to improve tax administration.[1]

TAS serves as the voice of the taxpayer within the IRS by providing the taxpayer's view on IRS policies, procedures, or programs. While systemic advocacy is the responsibility of everyone in TAS, primary oversight of systemic advocacy efforts belongs to the Office of Systemic Advocacy. Additionally, TAS administers the Low Income Taxpayer Clinic (LITC) grant program[2] and oversees the Taxpayer Advocacy Panel (TAP).[3]

TAS CASE RECEIPT CRITERIA

Taxpayers typically seek TAS assistance with specific issues when:

- They have experienced a tax problem that causes financial difficulty;
- They have been unable to resolve their issues directly with the IRS; or
- An IRS action or inaction has caused or will cause them to suffer a long-term adverse impact, including a violation of taxpayer rights.

TAS accepts cases in four categories: economic burden, systemic burden, best interest of the taxpayer, and public policy. See Figure 4.1.1, TAS Case Acceptance Criteria.

1 Taxpayers and practitioners can use the Systemic Advocacy Management System (SAMS) to submit systemic issues to TAS at http://www.irs.gov/sams.

2 The LITC program provides matching grants of up to $100,000 per year to qualifying organizations to operate clinics that represent low income taxpayers in disputes with the IRS and educate taxpayers for whom English is a second language about their taxpayer rights and responsibilities. LITCs provide services to eligible taxpayers for free or for no more than a nominal fee. *See* IRC § 7526.

3 TAP is a Federal Advisory Committee established by the Department of the Treasury to provide a taxpayer perspective on improving IRS service to taxpayers. TAS provides oversight and support to the TAP program. The Federal Advisory Committee Act (5 U.S.C. Appendix) prescribes standards for establishing advisory committees when those committees will furnish advice, ideas, and opinions to the federal government. *See also* 41 C.F.R. Part 102-3.

FIGURE 4.1.1

TAS Case Acceptance Criteria

As an independent organization within the IRS, TAS helps taxpayers resolve problems with the IRS and recommends changes to prevent future problems. TAS fulfills its statutory mission by working with taxpayers to resolve problems with the IRS.[1] TAS case acceptance criteria fall into four main categories.

Economic Burden	**Cases involving a financial difficulty to the taxpayer; an IRS action or inaction has caused or will cause negative financial consequences or have a long-term adverse impact on the taxpayer.**
Criteria 1	The taxpayer is experiencing economic harm or is about to suffer economic harm.
Criteria 2	The taxpayer is facing an immediate threat of adverse action.
Criteria 3	The taxpayer will incur significant costs if relief is not granted (including fees for professional representation).
Criteria 4	The taxpayer will suffer irreparable injury or long-term adverse impact if relief is not granted.
Systemic Burden[2]	**Cases in which an IRS process, system, or procedure has failed to operate as intended, and as a result the IRS has failed to timely respond to or resolve a taxpayer issue.**
Criteria 5	The taxpayer has experienced a delay of more than 30 days to resolve a tax account problem.
Criteria 6	The taxpayer has not received a response or resolution to the problem or inquiry by the date promised.
Criteria 7	A system or procedure has either failed to operate as intended, or failed to resolve the taxpayer's problem or dispute within the IRS.
Best Interest of the Taxpayer	**TAS acceptance of these cases will help ensure that taxpayers receive fair and equitable treatment and that their rights as taxpayers are protected.[3]**
Criteria 8	The manner in which the tax laws are being administered raises considerations of equity, or have impaired or will impair the taxpayer's rights.
Public Policy	**TAS acceptance of cases under this category will be determined by the National Taxpayer Advocate and will generally be based on a unique set of circumstances warranting assistance to certain taxpayers.[4]**
Criteria 9	The National Taxpayer Advocate determines compelling public policy warrants assistance to an individual or group of taxpayers.

1 IRC § 7803(c)(2)(A)(i).

2 TAS has changed its case acceptance criteria to generally stop accepting certain systemic burden issues. IRM 13.1.7.3(d), *Exceptions to TAS Criteria* (Feb. 4, 2015).

3 IRM 13.1.7.2.3, *TAS Case Criteria 8, Best Interest of the Taxpayer* (Feb. 4, 2015).

4 *See* Interim Guidance Memorandum (IGM) TAS-13-0414-001, *Interim Guidance on Accepting Cases Under TAS Case Criteria 9, Public Policy* (Apr. 2, 2014).

In many of the economic burden cases, time is critical. If the IRS does not act quickly (*e.g.*, to remove a levy or release a lien), the taxpayer will experience additional economic harm.[4] Best interest of the taxpayer (Criteria 8) includes breaches of the Taxpayer Bill of Rights (TBOR).[5] With respect to public policy cases (Criteria 9), the National Taxpayer Advocate has the sole authority to determine which issues are included in this criterion and will designate them by memo.[6]

REDEFINING TAS'S CASE ADVOCACY OPERATIONS

In the last year, as the demands for TAS's service have increased, TAS has implemented multiple strategies to focus on effectively advocating for taxpayers, as discussed below.

TAS Organizational Shift to Expanded and Additional Local Offices in Underserved Communities

TAS has focused staffing efforts based on the importance of TAS's local presence and its connection with communities, especially as other IRS functions reduce their geographic presence and become more centralized. The National Taxpayer Advocate established a realignment team to revisit TAS's geographic footprint and the allocation of staffing, considering population shifts and geographic centers with emerging issues. The team reviewed whether taxpayer access to TAS resources was sufficient and analyzed whether TAS could improve advocacy by realigning its staffing to better position offices for anticipated work due to strategic decisions the IRS is making.

In addition to reviewing its existing staffing footprint, TAS analyzed population totals, primary demographics (*e.g.*, education levels and poverty rates), English as a Second Language (ESL) taxpayers, military populations, and congressional districts. TAS weighed Metropolitan Statistical Area data within each state, as delineated by the Office of Management and Budget for collecting, tabulating, and publishing federal statistics. TAS considered the location of existing TAS offices, availability of walk-in service, public transportation, and access to LITCs. TAS also reviewed existing case advocate staffing, case receipts, capacity to work cases, and other factors, including how the future Taxpayer Advocate Service Integrated System (TASIS) environment will route cases.[7]

The National Taxpayer Advocate's plan is to realign staffing through attrition. TAS identified several underserved regions across the country. As part of a longer-term staffing initiative, TAS will expand its footprint in underserved areas, while shrinking existing staffing through attrition in certain other locations. TAS will be able to update the model to reflect future staffing needs, as significant changes occur. Accordingly, TAS opened a new office in San Jose, California in October 2015 and is opening offices in San Diego, California and St. Petersburg, Florida. The National Taxpayer Advocate initiated actions to fill the Local Taxpayer Advocate (LTA) positions for the three locations. TAS's realignment team continues to review other geographic areas for opportunities. TAS will proactively align future hiring and attrition to better serve its taxpayer base.

4 IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.1, *TAS Case Criteria 1-4, Economic Burden* (Feb. 4, 2015).

5 IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.3, *TAS Case Criteria 8, Best Interest of the Taxpayer* (Feb. 4, 2015). *See* TBOR, *available at* http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

6 IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.4, *TAS Case Criteria 9, TAS Public Policy* (Feb. 4, 2015). *See, e.g.*, *Interim Guidance on Accepting Cases Under TAS Case Criteria 9, Public Policy*, TAS-13-1115-007 (Nov. 2, 2015).

7 TAS uses the Taxpayer Advocate Management Information System (TAMIS) to record, control, and process cases and to analyze the issues that bring taxpayers to TAS. TAS retrieved the data for this report on the first day of the month following the end of each fiscal year (FY). TAS is developing an updated case management system called TASIS. *See* National Taxpayer Advocate FY 2014 Objectives Report to Congress, Section VII for a full discussion of TASIS.

Centralized Case Intake (CCI)

TAS has formally changed its approach to the case intake process as a step in its strategy to focus on its primary mission to serve the most vulnerable taxpayers. In FY 2014, TAS formed a partnership with the IRS's Wage and Investment (W&I) Business Operating Division (BOD) under the CCI Proof of Concept and expanded the process to all IRS employees staffing the National Taxpayer Advocate's toll-free line in FY 2015. Key objectives included:

- Creating the ability for taxpayers to speak directly with TAS employees on their issues;
- Providing more in-depth interviews with vulnerable taxpayers before bringing their cases into TAS;
- Educating and guiding taxpayers in resolving their issues; and
- Increasing the intake advocate workforce to handle call demand without limiting the time needed to help each taxpayer.

Previously, IRS employees dedicated to the NTA toll-free line[8] determined whether the taxpayers met TAS criteria, and, if appropriate, opened a case directly onto the TAMIS. Under the CCI, those IRS employees now transfer calls they believe meet TAS criteria directly to TAS intake advocates through the ASK-TAS1 toll-free line. The intake advocates on the TAS toll-free line create cases only after validating that the taxpayers meet TAS criteria.

Of the total calls answered by ASK-TAS1, the NTA toll-free line transferred in 62 percent (54,205) of the calls.[9] Of the transferred-in calls, nearly 83 percent (44,869) resulted in a TAS case created by the intake advocates.[10] Through this process, intake advocates addressed the taxpayers' concerns in the remaining 17 percent (9,336) of the contacts to avoid opening a new TAS case, allowing TAS to use its resources on more complex situations requiring its specialized skills.[11] In FY 2015, the total number of calls transferred to ASK-TAS1 almost tripled, and TAS helped almost 10,000 taxpayers without creating a case.

8 This number is 1-877-777-4778.

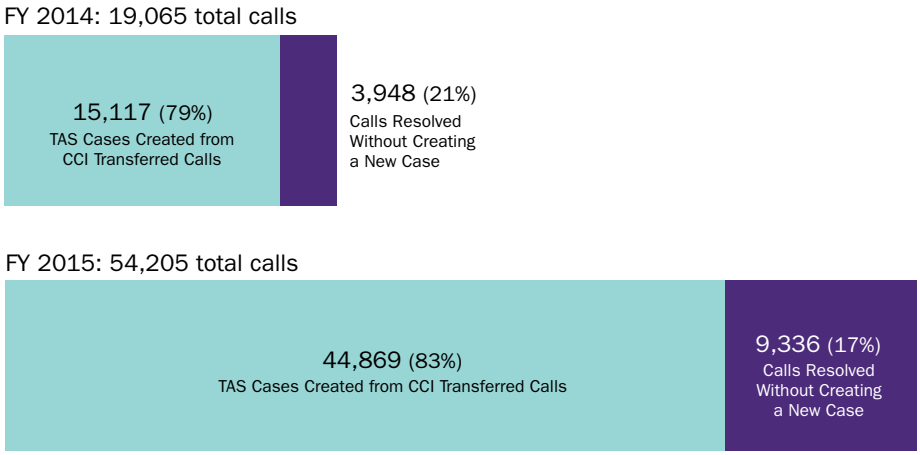
9 See IRS, *Aspect Application Activity Report*, (Oct. 1, 2014-Sept. 30, 2015).

10 Data obtained from TAMIS (Oct. 1, 2015).

11 This reflects calls resolved between Oct. 1, 2014 and Sept. 30, 2015.

FIGURE 4.1.2[12]

Phone Calls Transferred to the ASK-TAS1 Line and Resulting TAS Cases Created, FYs 2014–2015



TAS Promotes the Use of Self-Help Tools to Resolve Taxpayers' Issues

To ensure TAS is helping the most vulnerable taxpayers, intake advocates handling the initial contact with the taxpayer may direct taxpayers, who are able, to navigate automated self-help IRS tools on irs.gov. Taxpayers may use the tools to resolve their issues independently and expeditiously. Some examples of the available tools are *Where's My Refund?*, *Where's My Amended Return?*, the *Online Payment Tool*, a withholding calculator, and tools to estimate benefits of the Affordable Care Act (ACA).

Additionally, TAS will identify and test self-help tools for taxpayers to resolve requests for expedited, returned, or stopped refunds and requests for copies of certain documents (*e.g.*, returns, reports, determination letters) to ease their economic burden and prevent adverse consequences. In FY 2015, TAS created a series of short videos for taxpayers, including:

- *What to Do if You Owe the IRS and Can't Pay:*
  - *Overview;*[13]
  - *Installment Agreement;*[14]
  - *Currently Not Collectible;*[15]
- *Injured Spouse;*[16] and
- *Held/Stopped Refunds.*[17]

12 See IRS, *Aspect Application Activity Report*, (Oct. 1, 2014 – Sept. 30, 2015).
13 *Available at* http://www.youtube.com/watch?feature=player_embedded&v=AsOEV0revVE.
14 *Available at* http://www.youtube.com/watch?feature=player_embedded&v=_xTmF8GNos4.
15 *Available at* http://www.youtube.com/watch?feature=player_embedded&v=Yxysf1p5lvo.
16 *Available at* http://www.youtube.com/watch?feature=player_embedded&v=qhVcm9Phi1c.
17 *Available at* http://www.youtube.com/watch?feature=player_embedded&v=cyF_mwPTsjY.

Employee Training and Education

Throughout FY 2015, TAS employees received training on the TBOR provisions to enable them to incorporate taxpayer rights into their daily casework.[18] TAS employees will receive further education from the National Taxpayer Advocate's video presentation, *Using TBOR to Advocate for Taxpayers – Crosswalk,* at the all-employee symposium in FY 2016.

TAS is providing employees with enhanced guidance and detailed training on collection cases. During FY 2015, local offices included TAS Technical Advisors with collection backgrounds in staff meetings to discuss technical and procedural issues to improve advocacy efforts in collection cases. In response to TAS employees' concerns about workload distractions during training, TAS delivered "mini-symposiums" during the fall of 2015, taking employees off-line for two or three days, so they could concentrate on training. During TAS's FY 2016 symposium, all employees will watch a video featuring the National Taxpayer Advocate and T. Keith Fogg, the Acting Director of the Legal Services Center of Harvard Law School LITC, *Advocating When Working Collection Cases.* TAS delivered *Integrated Automation Technologies – Collection Suite Tools* to lead case advocates in FY 2015. All case advocates will receive the training as part of a financial analysis workshop in FY 2016. TAS will focus its resources further by releasing two videos in FY 2016: *TAS Awareness Training for Automated Collection System (ACS) Employees* and *TAS Awareness Training for Field Collection Employees*. The videos will improve the ability of IRS employees to recognize appropriate referrals to TAS, ensuring TAS assists taxpayers most in need of help.

Refinement of Quality Standards

TAS plans to refine its quality standards to better focus on its role of advocating for the taxpayer. The revised standards more closely align with TAS's guiding principle of advocacy and will enable TAS to better measure and emphasize advocacy efforts, such as resolving taxpayers' issues, protecting taxpayers' rights, and keeping taxpayers informed with complete and accurate information.

In FY 2016, TAS will:

- Continue to expand the CCI and intake processes to increase the capability for intake advocates to address, resolve, and provide relief for less complex issues, allowing case advocates more time to work more complex cases;
- Propose the expansion of the CCI process to accept transferred calls from other IRS toll-free lines when the taxpayer meets TAS criteria and the IRS is unable to resolve the taxpayer's issue the same day;
- Identify additional opportunities where intake advocates can assist taxpayers in resolving their issues independently and expeditiously by directing them to self-help tools, videos, and other automated IRS tools without the need to create a TAS case; and
- Complete the TAS expansion effort in St. Petersburg, Florida and San Diego, California.

18 IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.3, *TAS Case Criteria 8, Best Interest of the Taxpayer* (Feb. 4, 2015). *See* TBOR, *available at* http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

CASE RECEIPT TRENDS IN FY 2015

The Case Advocacy function in TAS has primary responsibility for direct contact with taxpayers, their representatives, and congressional staffs. Information from these contacts and the case results are vital to TAS's statutory missions to propose changes in the IRS's administrative practices to alleviate taxpayers' problems and to identify potential legislative changes to relieve such problems. Case Advocacy's findings and results flow into TAS's Systemic Advocacy programs and form the basis for many of the Most Serious Problems and the Legislative Recommendations in this report.

Volume of Cases

In FY 2015, TAS received 227,189 cases, a nearly five percent increase from FY 2014. TAS provided relief to taxpayers in approximately 78 percent of cases closed in FY 2015, consistent with FY 2014.[19] Figure 4.1.3 compares FY 2014 and FY 2015 case receipts and relief rates by case acceptance category.

FIGURE 4.1.3, TAS Case Receipts and Relief Rates, FYs 2014–2015[20]

Case Categories	Receipts FY 2014	Receipts FY 2015	Percent Change	Relief Rates FY 2014	Relief Rates FY 2015	Percent Change
Economic Burden	124,732	135,469	8.6%	75.4%	76.2%	1.0%
Systemic Burden	91,545	91,425	-0.1%	81.4%	81.7%	0.4%
Best Interest of Taxpayers	195	193	-1.0%	78.2%	75.9%	-3.0%
Public Policy	225	102	-54.7%	81.5%	76.9%	-5.6%
Total Cases	**216,697**	**227,189**	**4.8%**	**77.9%**	**78.4%**	**0.7%**

Case Complexity

TAS monitors the complexity of its work to ensure it meets taxpayers' needs efficiently by assigning workload to match the skills of its employees, by identifying when additional resources may be needed, such as technical advisor assistance[21] or counsel advice,[22] and by balancing case inventory levels between TAS offices to ensure prompt action will occur. TAS measures case complexity in a number of ways, including whether a case involves multiple issues or multiple tax periods and whether technical advice is needed, thus requiring more resources to resolve the matter.[23] Whether the multiple case issues are linked

19 TAS determines relief rates based upon whether it can provide full or partial relief or assistance on the issue initially identified by the taxpayer. Because TAS frequently provides relief on issues that differ from the ones initially identified, the relief rate as calculated is understated. Data obtained from TAMIS (Oct. 1, 2015).

20 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

21 IRM 13.1.12.1.1, *Technical Advisors Roles and Responsibilities* (Nov. 13, 2009), states in part that "Technical Advisors are responsible for resolving the most technically complex or sensitive issues using effective research, communication, coordination, and negotiating skills."

22 TAS employees often need legal advice to resolve their cases. Attorneys in the Office of Chief Counsel provide legal advice on the correct interpretation of the IRC. *See* IRC § 7803(b)(2) and IRM 13.1.10.2, *Obtaining Legal Advice From Chief Counsel* (April 9, 2012).

23 IRM 13.4.5.4, *Case Factors Screen* (July 16, 2012). TAS uses a complexity factor screen in its case management system. This screen contains 24 factors, where the presence of any one of these factors indicates greater case complexity. For example, one factor is whether the case involves analysis of the assessment, collection, or refund statute date to determine if it is about to expire. TAS is using this data for purposes of developing TASIS and will use the factors to assign cases in TASIS.

or separate, the case advocate (CA) must resolve all issues before closing the case.[24] CAs must identify primary and secondary core issues on cases and record them in TAMIS.[25]

Figure 4.1.4 represents the top ten sources of TAS receipts by primary core issue code (PCIC) categories from all sources without regard to TAS criteria, comparing FY 2014 and FY 2015. The "Other TAS Receipts" category encompasses the remaining PCICs not in the top ten.

FIGURE 4.1.4, Top 10 Issues for Cases Received in TAS, FYs 2014–2015[26]

Rank	Issue Description	FY 2014	FY 2015	FY 2015 Percent of Total	Percent Change FY 2014 to FY 2015
1	Identity Theft	43,690	56,174	24.7%	28.6%
2	Pre-Refund Wage Verification Hold	35,220	40,633	17.9%	15.4%
3	Processing Amended Return	10,245	11,847	5.2%	15.6%
4	Earned Income Tax Credit (EITC)	13,450	10,880	4.8%	-19.1%
5	Levy	8,086	7,977	3.5%	-1.3%
6	Processing Original Return	7,664	7,148	3.1%	-6.7%
7	Reconsideration of Audit and Substitute for Return under IRC § 6020(b)	6,768	6,723	3.0%	-0.7%
8	Unpostable and Reject	3,751	6,057	2.7%	61.5%
9	Returned and Stopped Refund	3,271	4,612	2.0%	41.0%
10	Injured Spouse Claim	7,284	4,604	2.0%	-36.8%
	Other TAS Receipts	77,268	70,534	31.0%	-8.7%
Total TAS Receipts		**216,697**	**227,189**		**4.8%**

The top five primary issue codes were consistent between FY 2014 and FY 2015. However, TAS experienced a nearly 29 percent increase in identity theft (IDT) cases in FY 2015, approaching the FY 2013 level of 57,929 cases. TAS's ongoing high volume of IDT cases and increased receipts in FY 2015 indicate that taxpayers continue to face sizeable, complex problems.[27] IDT cases remain the top source of TAS work.[28]

Erroneous information resulting from IDT can affect a victim's account for multiple tax periods and cause multiple issues, affecting the Accounts Management, Examination, and Collection functions. Other complex cases include collection cases (levy releases with alternative collection solutions, return of levy proceeds, offers in compromise (OIC), or seizure prevention), examination cases with multiple periods

24 IRM 13.1.21.1.1, *Introduction* (Feb. 1, 2011).

25 IRM 13.1.16.13.1, *Issue Codes* (Feb. 1, 2011). IRM 13.1.16.13.1.2, *Primary Core Issue Code* (Feb. 1, 2011), states the PCIC is a three-digit code that defines the most significant issue, policy, or process within the IRS that needs to be resolved. IRM 13.1.16.13.1.3, *Secondary Core Issue Code* (Feb. 1, 2011), states that the Secondary Core Issue Code (SCIC) identifies secondary issues and is used when a case has multiple issues.

26 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

27 *See* 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*, *supra*. National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance That Minimizes Burden and Anxiety for Such Taxpayers*) for a detailed discussion of the identity theft issues.

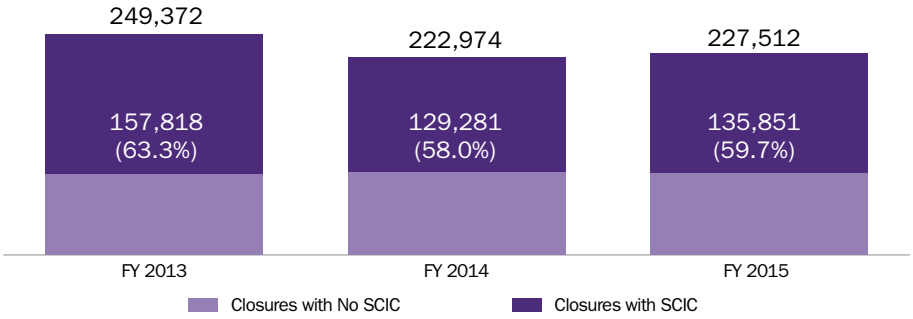
28 Data obtained from TAMIS (Oct. 1, 2015).

and technical issues, or income verification cases for self-employed persons with or without Earned Income Tax Credit (EITC) issues.

The percentage of cases that TAS closed with one or more SCICs increased slightly over the last year, from 58 percent in FY 2014 to 60 percent in FY 2015. These numbers indicate that a significant portion of TAS's inventory is complex, requiring more resources and time.[29]

FIGURE 4.1.5[30]

Closed Cases and Closures With Secondary Issue Codes (SCICs), FYs 2013–2015



In addition to cases with multiple issues, five percent of TAS closed cases in FY 2015 required the assistance of a technical advisor to understand and resolve the complexities of the cases.[31] Over 27 percent of TAS closed cases involved multiple tax periods.[32] Any of these factors can increase the time TAS spends resolving a taxpayer's overall issues.

Economic Burden Cases

Economic burden cases often occur where IRS processes are not functioning smoothly or taxpayers experience other systemic problems. For the fourth consecutive fiscal year, more than half of TAS receipts involved taxpayers experiencing economic burden.[33] Because these taxpayers face potential immediate adverse financial consequences, TAS requires employees to work the cases using accelerated timeframes.[34]

29 In FY 2013, of the 249,372 cases closed, 157,818 cases involved more than one issue. In FY 2014, of the 222,974 cases closed, 129,281 cases involved more than one issue. In FY 2015, of the 227,512 cases closed, 135,851 cases involved more than one issue code. Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

30 *Id*.

31 Data obtained from TAMIS (Oct. 1, 2015).

32 *Id.*

33 *See* National Taxpayer Advocate 2014 Annual Report to Congress 533 (TAS Case Advocacy), which reflects that 60.6 percent of TAS case receipts included economic burden factors in FY 2012.

34 IRM 13.1.16.12(1), *Case Advocate Case Assignment* (March 23, 2011) (Upon acceptance into the TAS program, cases are ready for assignment to CAs within two workdays of the Taxpayer Advocate Received Date (TARD) for Criteria 1-4 cases and three workdays of the TARD for Criteria 5-9 cases). IRM 13.1.18.3(1), *Initial Contact* (February 1, 2011) (the CA is to contact the taxpayer or representative by telephone within three workdays of the TARD for criteria 1-4 cases and within five workdays of the TARD for criteria 5-9 cases to notify of TAS's involvement.)

FIGURE 4.1.6[35]

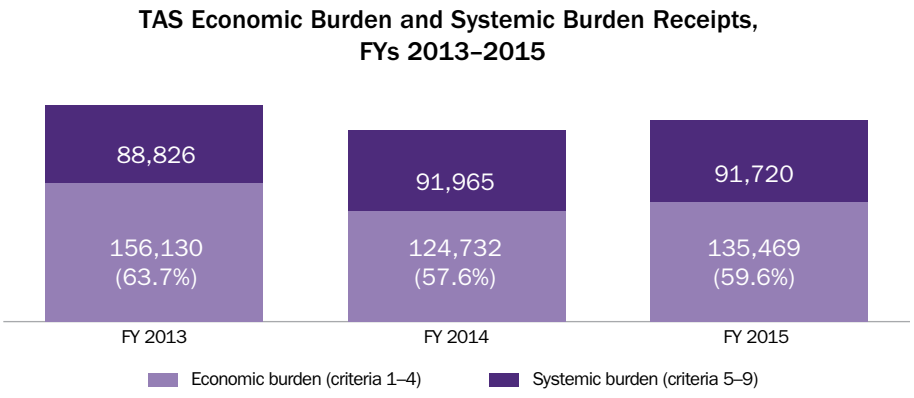


Figure 4.1.7 shows the top five issues driving economic burden receipts, which represent the bulk of the increase in economic burden cases. TAS dedicates significant resources to resolving the systemic causes of these issues, as discussed in the Most Serious Problems section of this and past reports.

FIGURE 4.1.7, Top Five Issues Causing Economic Burden (EB) Cases, FYs 2014–2015[36]

Rank	Issue Description	FY 2014	EB Receipts as % Total EB Receipts for Issue FY 2014	FY 2015	EB Receipts as % Total EB Receipts for Issue FY 2015	EB Percent Change FY 2014 to FY 2015
1	Identity Theft	31,160	25.0%	40,284	29.7%	29.3%
2	Pre-Refund Wage Verification Hold	20,917	16.8%	25,206	18.6%	20.5%
3	Earned Income Tax Credit (EITC)	10,519	8.4%	8,545	6.3%	-18.8%
4	Levy	7,206	5.8%	7,074	5.2%	-1.8%
5	Processing Amended Return	4,713	3.8%	5,331	3.9%	13.1%

Identity Theft

IDT, which occurs when an individual intentionally uses the personal identifying information of another person to file a false tax return with the intention of obtaining an unauthorized refund, continued as the number one reason taxpayers sought TAS's assistance.[37] In FY 2015, IDT receipts comprised 25 percent

35 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

36 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015). TAS computed the top five economic burden issue codes using only the PCIC. Often TAS cases involve more than one issue and TAS tracks this data; however, these are not included within this computation to avoid counting a case more than once.

37 The IRS refers to this type of tax-related identity theft as "refund-related" identity theft. In "employment-related" IDT, an individual files a tax return using his or her own taxpayer identification number, but uses another individual's Social Security number (SSN) to obtain employment, and consequently, the wages are reported to the IRS under the SSN. IRM 25.23.1.4.1, *Identity Theft in Tax Administration* (Sept. 2, 2015). The IRS has procedures in place to minimize the tax administration impact to the victim in these employment-related identity theft situations. *See* IRM 25.23.2.20.5, *Employment-Related Identity Theft* (Sept. 8, 2015), for an example of those procedures. Accordingly, TAS will focus on refund-related IDT in this report.

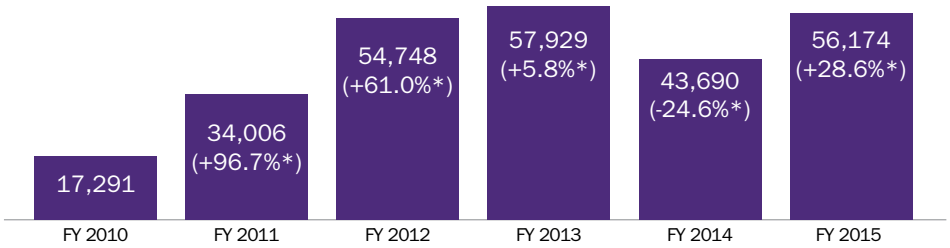
of all receipts and nearly 30 percent of economic burden receipts. The National Taxpayer Advocate first addressed the issue as a Most Serious Problem affecting taxpayers in 2004, identifying further problems and recommending solutions in subsequent reports.[38]

IDT victims often come to TAS when they are experiencing a hardship to obtain expedited resolution. Since 2010, TAS has helped over 263,000 IDT victims resolve their account problems.[39] In FY 2015, TAS obtained relief for a significant majority of taxpayers in IDT cases with about 80 percent of taxpayers receiving relief.[40] The FY 2015 average time to work an IDT case to its conclusion of 68 days is a 16 percent improvement from 81 days in FY 2014 and significantly less than the IRS's normal processing time of 180 days.[41] TAS closed 54,849 IDT cases in FY 2015, including about 72 percent with economic burden.[42]

As Figures 4.1.8 and 4.1.9 demonstrate, TAS's IDT inventories have increased from FY 2014 to FY 2015, while TAS's timeframes for completing IDT cases are improving over time.

FIGURE 4.1.8[43]

TAS Identity Theft Case Receipts and Percentage Changes, FYs 2010–2015



*Change compared to prior year

38 See 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*, *supra*; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67; National Taxpayer Advocate 2011 Annual Report to Congress 48-68; National Taxpayer Advocate 2009 Annual Report to Congress 307-11; National Taxpayer Advocate 2008 Annual Report to Congress 79-93; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36.

39 Data obtained from TAMIS (Oct. 1, 2015).

40 *Id.*

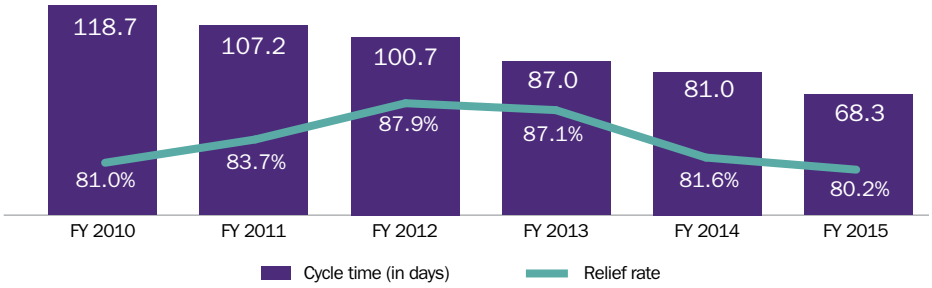
41 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

42 Data obtained from TAMIS (Oct. 1, 2015).

43 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct 1, 2014; Oct. 1, 2015).

FIGURE 4.1.9[44]

Identity Theft Relief Rate and Cycle Time, FYs 2010–2015



Pre-Refund Wage Verification Holds

The IRS employs various filters and data mining techniques in an attempt to prevent processing fraudulent returns and issuing fraudulent refunds. These preventive measures may also delay taxpayers' valid returns from timely processing, blocking timely receipt of refunds. When the IRS receives more questionable returns than it has resources to evaluate properly, it places holds on the associated refunds. In the past, the IRS's actions have raised significant taxpayer rights issues and brought increasing numbers of taxpayers to TAS.[45]

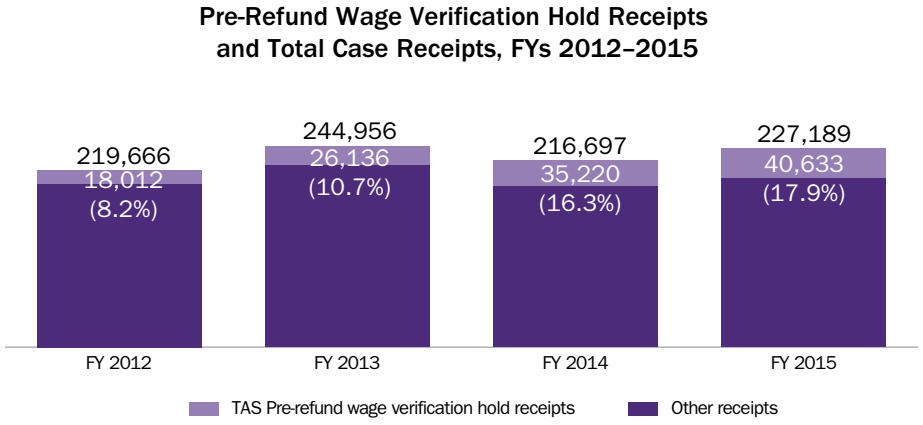
This year, as in the past, pre-refund wage verification holds under the Return Integrity and Compliance Services Program (RICS) constituted the second most frequent reason that taxpayers came to TAS for assistance. Pre-refund wage verification hold cases remained at nearly 18 percent of TAS's total inventory in FY 2015, after almost doubling between FYs 2012 and 2014. The volume of TAS cases reinforces the presence of significant systemic and procedural issues in the RICS program.[46]

44 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct 1, 2014; Oct. 1, 2015).

45 See National Taxpayer Advocate 2005 Annual Report to Congress 25, addressing the IRS's Questionable Refund Program (subsequently called the RICS program) that failed to provide taxpayers with adequate due process protections and failed to maintain an adequate system to vet the IRS's concerns about taxpayer refund claims.

46 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*, *supra*. For additional discussion, see National Taxpayer Advocate FY 2015 Objectives Report to Congress 143-45 (*TAS Receipts Suggest the IRS Needs to Enhance Efforts to Detect and Prevent Refund Fraud*).

FIGURE 4.1.10[47]



While the National Taxpayer Advocate makes recommendations to the IRS regarding improvements to the income verification programs,[48] TAS continues to provide advocacy to the taxpayers who come to TAS when the IRS delays their refunds under these programs. Generally, TAS achieves almost a 78 percent relief rate[49] and an 89 percent customer satisfaction rate in these cases.[50] The cycle time of these cases is about 58 days on average.[51]

Earned Income Tax Credit Cases

The EITC is a refundable tax credit that provides an important economic benefit for low income taxpayers who have earned income.[52] TAS's FY 2015 EITC receipts were the fourth highest source of TAS's cases.[53] About 79 percent of the FY 2015 EITC cases involved taxpayers experiencing an economic burden.[54]

47 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

48 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*, *supra*.

49 Data obtained from TAMIS (Oct. 1, 2015).

50 TAS customer satisfaction is determined using a survey administered by a contractor. TAS measures customer satisfaction by the percent of taxpayers who indicate they are very satisfied or somewhat satisfied with the service provided by TAS. The FY 2015 year-to-date results are from the third quarter FY 2015 National Summary by PCICs from the contractor's results.

51 Data obtained from TAMIS (Oct. 1, 2015).

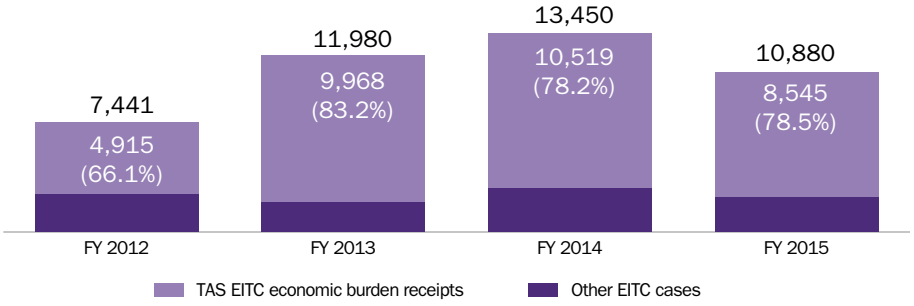
52 The benefit is available for low income taxpayers without children but is more significant for those with children. The maximum benefit for tax year 2014 (returns filed in 2015) was $6,143 with three or more qualifying children and $496 with no qualifying children. IRS Publication 596, *Earned Income Credit* (EIC), 29-35 (Dec. 18, 2014).

53 See Most Serious Problem: *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, Most Serious Problem: 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; and 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*, *supra*. Data obtained from TAMIS (Oct. 1, 2014).

54 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

FIGURE 4.1.11[55]

TAS EITC Economic Burden and Total Case Receipts, FYs 2012–2015



The EITC is complex yet its recipients are in the lower economic strata and often the least able to navigate complicated IRS processes. Low income taxpayers are found more frequently among the elderly, the disabled, Native Americans, and taxpayers with limited English proficiency.[56] TAS taxpayers typically face difficulty substantiating the EITC's residency and relationship requirements.[57] Taxpayers experiencing the most problems are those with non-traditional family relationships (where the child is not the biological child of the taxpayer claiming the credit) for whom documentation requirements can be overwhelming (*e.g.*, the need to obtain birth certificates for various individuals to establish the required relationship for a niece, nephew, or other extended relative). Migratory living patterns, lack of education, lack of time (*e.g.*, holding multiple jobs), lack of transportation, and limited access to technology (*e.g.*, internet, fax) add to the difficulty of finding and submitting documents.[58]

TAS is engaging with W&I to develop more effective ways to administer EITC examinations.[59] TAS employees serve on the cross-functional EITC Audit Improvement Team and continue to recommend improvements to the document sent to taxpayers, Form 886-H-EIC, *Documents You Need to Prove You Can Claim an Earned Income Credit on the Basis of a Qualifying Child or Children*. In January 2015, the IRS implemented the team's suggestion to change the EITC script on the TeleTax Line to improve the service provided to EITC taxpayers. The team also developed a video to expand taxpayers' understanding of EITC requirements. The team currently is creating improved training for telephone assistors to promote meaningful conversations with taxpayers with EITC questions. The goal of the improved training is to

55 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

56 *See* National Taxpayer Advocate 2013 Annual Report to Congress 109; National Taxpayer Advocate 2011 Annual Report to Congress 296, 304; National Taxpayer Advocate 2009 Annual Report to Congress 110.

57 To claim a child for the EITC, the child must be a "qualifying child" and must meet three tests: age, relationship, and residency. Pursuant to IRC § 32(c)(3)(A), the EITC generally relies on the definition of qualifying child found in IRC § 152. The **Relationship** test requires that the child be the taxpayer's child (including an adopted child, stepchild, or eligible foster child), brother, sister, stepbrother, stepsister, or descendant of one of these relatives. *See* IRC §§ 152(c)(2) and 152(f)(1). The **Residency** test requires that the qualifying child must live with the taxpayer for more than half of the tax year (exceptions apply for temporary absences for special circumstances, *e.g.*, children who were born or died during the year, children of divorced or separated parents, and kidnapped children). *See* IRC §§ 152(c)(1)(B), (e), (f)(6); and Treas. Reg. § 1.152-1(b). The **Age** test requires the child be younger than the taxpayer and fall under one of these age categories: under age 19, under age 24 and a full-time student, or a child of any age who is permanently and totally disabled. *See* IRC § 152(c)(3).

58 *See* National Taxpayer Advocate 2013 Annual Report to Congress, 109 (Most Serious Problem: *Earned Income Tax Credit: The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*).

59 *See* Most Serious Problem: *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*, *supra*.

encourage a conversation between the IRS examiner and the taxpayer. The training will occur before the upcoming filing season.

TAS CAs are receiving further training on how best to serve the EITC taxpayer. These taxpayers rely on TAS for assistance to interpret the meaning of the letters received from the IRS, to assist in gathering documentation, or to deal with collection activities if the EITC taxpayer never received, or responded to, the IRS's correspondence.

The IRS primarily relies upon correspondence audits, which create problems for EITC taxpayers due to the characteristics of this population, as described above. To counter this, the CAs must communicate with the EITC taxpayer in a more complete and understandable manner than the IRS's correspondence when the EITC taxpayer contacts TAS for assistance. TAS is committed to training its CAs to improve communication with the EITC taxpayer. TAS initiatives to improve its own EITC casework include actions by an EITC subject matter expert to share best practices for better communication between the CA and the EITC taxpayer and emphasis on issue development through a more personalized approach. TAS tailors the approach to the particular needs of the EITC taxpayers, which may include assistance with the preparation of affidavits for the EITC taxpayer, the suggestion of alternative documentation when traditional documentation is not available, and direct contact with third parties.[60]

To open another avenue of communication with the EITC taxpayer, TAS participates in the IRS Digital Communications Project, which will allow non-traditional forms of communication between taxpayers and the IRS.[61] The National Taxpayer Advocate selected EITC taxpayers to be part of the trial to determine whether EITC taxpayers can effectively communicate digitally with their CAs once they have an open case in TAS. The non-traditional forms of communication may benefit the low income taxpayer, who may no longer have a landline telephone or access to a permanent address for mail. Instead of the necessity of copying a birth certificate and placing the copy in the mail to the IRS, which involves cost and time, an EITC taxpayer will be able to take a photo of the document with a cell phone and send it to the CA. Such innovations in communication are yet another method TAS is planning to use to better advocate for and educate EITC taxpayers.

As discussed in several Most Serious Problems in this report,[62] the National Taxpayer Advocate encourages the IRS to improve compliance through better taxpayer service and audit strategies, with the goal of educating the EITC taxpayer on the rules of the credit. CAs are part of the process as well. In EITC cases, the CA reminds the taxpayers of the rules for qualifying children, the necessity for documentation, and methods to show the IRS that they are entitled to the credit claimed. If taxpayers have improperly

60 EITC cases present TAS leadership with an improvement opportunity. In FY 2015, the average relief rate on EITC cases was over 63 percent compared to approximately 78 percent for all cases. TAS has taken a number of steps to improve its service to these taxpayers, including EITC training for field employees led by the National Taxpayer Advocate, decentralization of all EITC casework so the cases may be worked in local offices, and EITC case reviews by TAS leadership to identify the aspects of the credit that require additional training.

61 *See* National Taxpayer Advocate 2014 Annual Report to Congress 161 (Most Serious Problem: *Virtual Service Delivery (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet Video Conferencing*).

62 *See* Most Serious Problem: *2015 EITC Introduction*; Most Serious Problem: *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*; Most Serious Problem: *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; and* 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*, *supra*.

claimed the EITC, CAs ensure that these taxpayers understand the rules and can use this knowledge in the future to be compliant with tax laws.

Affordable Care Act

In FY 2015, TAS received 3,758 cases in which the taxpayer needed assistance with an aspect of the ACA.[63] While this was not a substantial source of cases, FY 2015 was the first year in which the IRS required taxpayers to report whether or not they had qualifying health insurance; thus, FY 2015 was the first year TAS received cases related to the ACA. Taxpayers who received insurance through the Health Insurance Marketplace[64] received Form 1095-A, *Health Insurance Marketplace Statement,* which provided information that many taxpayers needed to complete their tax returns accurately. Eligible taxpayers may have received the Premium Tax Credit (PTC)[65] to help offset the cost of health insurance purchased through the marketplace, and some may have received the PTC in advance, known as the Advanced Premium Tax Credit (APTC).[66] In both situations, the taxpayers had to file Form 8962, *Premium Tax Credit*, with their tax returns to reconcile their credits.

Of the taxpayers who came to TAS with ACA problems, over 72 percent were experiencing an economic burden.[67] In 88 percent of ACA cases, the taxpayers experienced a problem with the PTC.[68] Most taxpayers with PTC issues contacted TAS because the IRS delayed their returns and refunds due to:

- Third-party data matching problems;
- Missing a correct Form 8962 to reconcile the APTC;
- A programming problem that improperly offset refunds against Individual Shared Responsibility Payment (ISRP) balances;
- Delays in IRS processing of PTC claims selected for audit; and
- Issues with establishing the second lowest cost silver plan for taxpayers claiming the PTC on their tax return.

Because this was the first year the IRS was dealing with ACA cases, TAS was prepared to see a number of systemic issues that would lead to an influx of ACA cases. TAS created a Rapid Response Team — a cross-functional team of TAS employees — that worked together to immediately respond to potential ACA issues and identify where there was an issue it needed to elevate to the IRS. The team identified a number of processing problems and worked with the IRS to resolve them.[69] This proactive approach to a new issue allowed TAS to resolve issues quickly and prevent additional cases from coming to TAS.

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63 Pub. L. No. 111-148, 124 Stat. 119 (March 23, 2010). *See* 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*, *supra*.

64 The Health Insurance Marketplace, also called the "Exchange," is a state or federally operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or who buy insurance on their own. *See* http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace. IRC § 6055 and the regulations thereunder require every person (*i.e.*, health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage) that provides minimum essential coverage (as defined in IRC § 5000A(f)) to an individual to report to the IRS information about the coverage of each individual covered under the policy.

65 IRC § 36B.

66 Pub. L. No. 111-148, § 1412, 124 Stat. 119, 231 (March 23, 2010).

67 Data obtained from TAMIS (Oct. 1, 2015).

68 *Id*.

69 *See* National Taxpayer Advocate FY 2016 Objectives Report to Congress 38-47 (*The IRS's Administration of the Affordable Care Act Has Done Well Over All, But Some Glitches Have Arisen*).

Additionally, TAS trained all employees in skills needed to work ACA cases. During FY 2015, TAS employees received an intensive week-long training on the ACA, which included advocacy points on the PTC and the ISRP. TAS also trained its technical advisors in ACA collection procedures at a technical symposium in FY 2015, and the material will be available to all TAS employees in FY 2016. In addition, CAs will receive just-in-time training on the Employer Shared Responsibility Payment (ESRP)[70] in FY 2016, prior to the start of the filing season when income tax returns will first include the ESRP.[71]

Collection Cases

TAS's total case receipts with collection issues were 21,936 in FY 2014 and 22,084 in FY 2015, a change of less than one percent.[72] The IRS's use of levies and liens declined during these periods, as shown in Figures 4.1.12 and 4.1.13.[73] Despite the reduction in liens and levies issued, the IRS's use of them accounted for about 50 percent of TAS's contact from taxpayers with collection issues in FYs 2014-2015, with about 86 percent of those cases involving economic burden in both years.[74]

FIGURE 4.1.12, IRS Levy Volume and TAS Levy Case Receipts, FYs 2010–2015[75]

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
TAS Levy Receipts	18,015	15,466	11,419	8,829	8,086	7,977
IRS Levy Volume	3,606,818	3,748,884	2,961,162	1,855,095	1,995,987	1,464,026

FIGURE 4.1.13, IRS Lien Volume and TAS Lien Case Receipts, FYs 2010–2015[76]

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
TAS Lien Receipts	4,927	4,637	3,527	3,147	2,946	3,051
IRS Lien Volume	1,096,376	1,042,230	707,768	602,005	535,580	393,704

70 IRC § 4980H.

71 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*, *supra*.

72 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

73 See Most Serious Problem: *Notices of Federal Tax Lien (NFTL): The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than a Thorough Analysis of a Taxpayer's Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection*; and Most Serious Problem: *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*, *supra*. In FY 2014, TAS's case receipts for all collection PCICs were 21,936. In FY 2015, they were 22,084, an increase of less than one percent. From FY 2010 to FY 2015, levies issued by the IRS decreased by almost 60 percent and lien filings decreased by 64 percent. IRS, Collection Activity Reports, NO-5000-24, *Levy and Seizure Report* (FYs 2010 to 2015); IRS, *Collection Activity Reports*, NO-5000-25, Liens Report (FYs 2010 to 2015).

74 Data obtained from TAMIS (Sept. 30, 2014; Oct. 1, 2015). In FY 2014, TAS had 8,086 levy cases and 2,946 lien cases, equaling 11,032 cases, or 50.3 percent of the total. Of the 11,032, 7,206 levy cases and 2,254 lien cases were economic burden, totaling 9,460, or 85.8 percent. In FY 2015, TAS had 7,977 levy cases and 3,051 lien cases for a total of 11,028 cases, or 49.9 percent of the total collection cases. Of the 11,028 cases, 7,074 levy cases and 2,372 lien cases were economic burden, or 85.7 percent.

75 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014, Oct. 1, 2015). IRS, 5000-23 Collection Workload Indicators (Mar. 22, 2011; Oct. 11, 2011); IRS, 5000-25 Collection Activity Report (Oct. 1, 2012; Sept. 30, 2013; Sept. 29, 2014, Oct. 9, 2015)

76 *Id*. IRS, 5000-24 Collection Activity Report (Oct. 9, 2012; Oct. 22, 2013); IRS, 5000-25 Collection Activity Report (Oct. 6, 2014, Oct. 7, 2015).

In FY 2015, collection issues accounted for almost 11 percent of all economic burden receipts and over ten percent of TAS's total caseload.[77] Collection issues are vitally important to affected taxpayers because while IRS collection tools (bank levies, wage levies, personal residence seizures, and the filing of Notices of Federal Tax Lien (NFTL)) significantly affect all taxpayers, they can have a particularly devastating impact on those with low incomes.

TAS provided relief in about 73 percent of these cases in FY 2015, compared to approximately 78 percent on all issues.[78] In FY 2015, TAS issued 30 Taxpayer Assistance Orders (TAOs)[79] in collection cases where the IRS did not agree with TAS's recommendations initially. Of these 30 TAOs, the IRS complied with 23 in an average of 14 days, meaning the IRS's negative responses to TAS's requests unnecessarily delayed resolution, adding to the harm to the taxpayers, when there was no material disagreement as to the resolution.[80]

TAS provided suggestions to the Office of Special Penalties (OSP) about the reasonable cause and evidence sections on its website. TAS is working with OSP to add an electronic penalty abatement request process to the existing electronic installment agreement request process to help taxpayers receive timelier penalty abatement responses.

TAS Operations Assistance Request Trends

To serve taxpayers more efficiently, the Commissioner delegated to the National Taxpayer Advocate certain tax administration authorities that do not conflict with or undermine TAS's unique statutory mission but allow TAS to resolve routine problems.[81] When TAS lacks the statutory or delegated authority to resolve a taxpayer's problem, it works with the responsible IRS BOD or function to resolve the issue, a process necessary in 66 percent of all TAS cases closed in FY 2013, 67 percent in FY 2014, and 65 percent in FY 2015.[82] After independently reviewing the facts and circumstances of a case and communicating with the taxpayer, TAS uses Form 12412, *Operations Assistance Request*, to convey a recommendation or requested action for the IRS to resolve the issue, along with documentation. The Operations Assistance Request (OAR) also serves as an advocacy tool by:

- Giving the IRS a second chance to resolve the issue;
- Giving TAS and the BOD a chance to resolve the issue without having to elevate it; and
- Documenting systemic trends that could lead to improvements in IRS processes.

All BODs agreed to work TAS cases on a priority basis and expedite the process for taxpayers whose circumstances warrant immediate handling. The Service Level Agreements require the BODs to direct resources to process OARs. The OAR report alerts the BODs to the number of taxpayers who seek TAS assistance because they have not been able to resolve their problems through regular channels within the BODs' control and the types of issues. Form 12412 includes an "expedite" box that TAS CAs can check when the BOD needs to act immediately to relieve the taxpayer's hardship.

77 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

78 Data obtained from TAMIS (Oct. 1, 2015).

79 For a detailed discussion of TAOs, see *TAS Uses Taxpayer Assistance Orders to Advocate Effectively in Taxpayer Cases*, *infra*. TAO compliance data is as of Oct. 1, 2015.

80 Data obtained from TAMIS (Oct. 1, 2015).

81 IRM 1.2.50.3(1), *Delegation Order 13-2 (Rev. 1)* (March 3, 2008) Authority of the National Taxpayer Advocate to Perform Certain Tax Administration Functions.

82 TAS closed 165,003 OARs in 2013; 149,484 OARs in FY 2014; and 148,305 OARs in FY 2015. Data obtained from TAMIS (Oct. 18, 2013; Oct. 6, 2014, and Oct. 5, 2015).

TAS generally sends one or more OARs on individual cases to secure action by the IRS, but TAS may use a single OAR to work the same issue for multiple taxpayers, which is called a "mass OAR." During the 2015 filing season, TAS issued a mass OAR on behalf of 158 IDT victims who had unprotected but validated TAS taxpayer accounts.[83] TAS took this action to ensure timely marking of these accounts to allow the taxpayers to receive Identity Protection PINs (IP PIN).[84] TAS worked with the IRS to update the accounts quickly, allowing the taxpayers to file returns without having to worry that an identity thief would file first using their Social Security numbers, causing processing problems for the taxpayers.

Figure 4.1.14 reflects the number of OARs issued by BOD needing expedited action.

FIGURE 4.1.14, Expedited and Non-Expedited OARs Issued by BOD, FY 2015[85]

Business Operating Division	FY 2015 OARs Issued Requesting Expedite Action	FY 2015 OARs Issued without Expedite Request	FY 2015 Total OARs Issued
Appeals	243	509	752
Criminal Investigation	32	54	86
Large Business & International	188	442	630
Small Business/Self-Employed	16,665	23,712	40,377
Tax Exempt/Governmental Entity	528	863	1,391
Wage & Investment	113,703	97,732	211,435
Total	**131,359**	**123,312**	**254,671**

TAS Uses Taxpayer Assistance Orders to Advocate Effectively

The TAO is a powerful statutory tool delegated by the National Taxpayer Advocate to the LTAs to resolve taxpayer cases.[86] An LTA may issue a TAO to order the IRS to take certain actions, cease certain actions, or refrain from taking certain actions.[87] A TAO may order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level.[88] When a taxpayer faces significant hardship and the facts support relief, an LTA may issue a TAO when the IRS refuses or otherwise fails to take the action TAS has requested to resolve the case.[89] Once TAS issues a TAO, the BOD must comply with the request or appeal the issue for resolution at higher levels.[90] The BOD cannot take action on the case while the TAO is on appeal.[91]

83 Data obtained from TAMIS (Oct. 1, 2015).

84 An IP PIN is a single-use six-digit identification number the IRS issues to IDT victims so that they can file their returns with the assurance that the identity thief cannot file first. The process of validating a taxpayer's identity and marking the account must be complete before the IRS sends the IP PIN notices prior to the commencement of the filing season.

85 Data obtained from TAMIS (Oct. 1, 2015).

86 IRC § 7811(f) states that for purposes of this section, the term "National Taxpayer Advocate" includes any designee of the National Taxpayer Advocate. *See* IRM 1.2.50.2, *Delegation Order* 13-1 (Rev. 1) (March 17, 2009).

87 IRC § 7811(b); Treas. Reg. § 301.7811-1(c)(3); IRM 13.1.20.3, *Purpose of Taxpayer Assistance Orders* (Dec. 15, 2007).

88 Treas. Reg. § 301.7811-1(c)(3): IRM 13.1.20.3 (Dec. 15, 2007).

89 IRC § 7811(a)(1); Treas. Reg. § 301.7811-1(a)(1) and (c).

90 IRM 13.1.20.5(2), *TAO Appeal Process* (Feb. 10, 2015).

91 IRC § 7811(c)(1) and Treas. Reg. § 301.7811-1(b).

In FY 2015, TAS issued 236 TAOs,[92] including 27 in cases where the IRS failed to respond to an OAR, further delaying relief to taxpayers. Of these 27 TAOs, the IRS complied with 23 in an average of 23 days, meaning the IRS did not have a significant disagreement as to the resolution and the taxpayers could have had relief sooner if the IRS had been more responsive to TAS.[93] Figure 4.1.15 reflects the results of all TAOs. Figure 4.1.16 shows the TAOs issued by fiscal year.

FIGURE 4.1.15, Actions Taken on FY 2015 TAOs Issued[94]

Action	Total
IRS Complied with the TAO	154
IRS Complied after the TAO was modified	0
TAS Rescinded the TAO	13
TAO Pending in Process	69
Total	**236**

FIGURE 4.1.16, TAOs Issued to the IRS, FYs 2011–2015[95]

Fiscal Year	TAOs Issued
2011	422
2012	434
2013	353
2014	362
2015	236

The LTAs have discretion to issue a TAO based on the facts and circumstances of each case. TAS leadership has review requirements geared toward prompt identification of situations in which a TAO is needed. In prior years, TAS encountered issues such as disaster area relief needs, the government shutdown, significant tax law changes such as the First-Time Homebuyer Credit, IRS procedural concerns such as the return preparer misconduct issue, or IRS processing glitches such as the First-Time Homebuyer Credit repayment that generated TAO issuances. In FY 2015, return preparer misconduct accounted for 43 TAOs.[96]

In FY 2015, TAS held discussions on the TAO process and its use during the Advocacy 360 leadership calls, which TAS initiated to emphasize all facets of advocacy beyond issuing TAOs and to strengthen awareness of situations needing a TAO. TAS leaders conducted Case Advocacy Leadership meetings in each TAS area, including a session emphasizing the TAO tool's use in resolving taxpayers' cases. These activities will continue in FY 2016.

92 Data obtained from TAMIS (Oct. 1, 2015).
93 *Id.*
94 *Id.*
95 Data obtained from TAMIS (Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).
96 Data obtained from TAMIS (Oct. 1, 2015).

IRS Confusion About TAS's Role and Authority in the TAO Context

FY 2015 was a particularly contentious year with respect to TAOs. IRS employees improperly delayed or placed conditions upon TAS and the National Taxpayer Advocate's access to case-specific information, which resulted in one or more TAOs that should not have been necessary.[97] For example, in cases involving taxpayers trying to settle with the IRS in connection with the Offshore Voluntary Disclosure (OVD) Program, IRS Revenue Agents (RAs) balked at providing TAS with access to: the taxpayer's administrative file, meetings with the taxpayer that the taxpayer requested that TAS attend, the RA's recommendations to the OVD review committee, and the committee's responses. In response to a TAO, even a head of office was confused about whether it was appropriate to allow TAS employees to attend meetings with a taxpayer that TAS was assisting.

In other cases, IRS employees attempted to take actions that the TAO specifically ordered the IRS not to take[98] while the TAO was on appeal. This is a violation of IRC § 7811.[99] IRS employees have also challenged whether a TAO was appropriate in some cases, alleging that the taxpayer was not suffering or about to suffer a "significant hardship." The determination of whether there is a significant hardship for purposes of issuing a TAO, however, can only be made by the National Taxpayer Advocate and her delegates, not other IRS employees. These problems illustrate the need for the IRS to work with TAS to deliver training to its employees so they understand TAS's role and its authorities, particularly in the context of a TAO issued to the IRS.

The following examples illustrate the use of TAOs to obtain taxpayer relief. To comply with IRC § 6103, which generally requires the IRS to keep taxpayers' returns and return information confidential, the details of the fact patterns have been changed. In certain examples, TAS has obtained the written consent of the taxpayer to provide more detailed facts.

TAOs Involving Account Resolution

As discussed above, IDT can adversely affect taxpayers. Approximately 74 percent of individual taxpayers filing returns claimed refunds, averaging about $2,700.[100] In an IDT situation, where the IRS has processed a false return before the actual taxpayer files a return, the IRS will not issue a refund to the actual taxpayer until the IRS fully resolves the SSN ownership, which can take 180 days.[101] In FY 2015, TAS issued eight TAOs involving IDT. The IRS complied with five of these TAOs within an average of 13 days.[102] TAS issued six IDT-related TAOs in cases that met economic burden case criteria and thus

97 Like all IRS employees, TAS employees are authorized to access any information they need to do their jobs. *See, e.g.*, IRC § 6103(h) ("Returns and return information shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes.").

98 See IRC § 7811(b)(2).

99 IRC § 7811(c)(1) explicitly provides that only the National Taxpayer Advocate, the Commissioner, or Deputy Commissioner can rescind a TAO. The regulations clarify further that "a TAO is an order by the National Taxpayer Advocate to the IRS. The IRS will comply with a TAO unless it is appealed and then modified or rescinded by the National Taxpayer Advocate, the Commissioner, or the Deputy Commissioner." Treas. Reg. § 301.7811-1(b).

100 IRS, 2015 IMF Filing Season Report, Week Ending May 15, 2015. Through May 15, 2015, the IRS received 138,209 million individual tax returns, of which 101,407 million claimed a refund averaging $2,698.

101 IRM 25.23.3.2.2(f) *Tax-Related Identity Theft* (Oct 1, 2015).

102 Data obtained from TAMIS (Oct. 1, 2015).

needed expedited case handling.[103] Specific examples of hardships encountered by these taxpayers and exacerbated by IRS delays included:

- Taxpayer was being evicted;
- Taxpayer needed to pay rent and utilities; and
- Taxpayer was behind on bills and needed to repair auto to get to work.

TAS issued 81 TAOs involving account resolution for non-IDT, non-return preparer misconduct issues, and non-exam issues. Here are some examples:

- The taxpayer made a payment that did not post to the account. The taxpayer provided the cancelled check with a letter from the bank, confirming that the taxpayer paid the IRS, as well as Form 8109-B, *Federal Tax Deposit Coupon*, from the bank. The IRS would not credit the taxpayer's account. TAS issued a TAO, stating that the taxpayer substantiated the payment under the IRM procedures and that the IRS must credit the taxpayer's account.[104] The IRS located the misapplied payment and moved it to the correct account, complying with the TAO.[105]
- The taxpayer contacted TAS regarding an injured spouse refund.[106] The taxpayer's withholding was the sole source of the refund, and thus was entitled to a refund rather than having it applied to a liability of a former spouse. Once the IRS completed the actions to issue the injured spouse a refund, TAS asked for permission to do an expedited manual refund. Despite TAS's request, the IRS deposited the entire refund directly to a bank account solely belonging to the former spouse, who refused to give it to the TAS taxpayer. After issuing a TAO, Chief Counsel to the IRS supported TAS's position that the IRS made an erroneous refund.[107] As a result, the IRS correctly issued the refund to the TAS taxpayer.[108]
- The taxpayer filed a Form 1120-X, *Amended U.S. Corporation Income Tax Return*, to claim additional Foreign Tax Credit. The IRS processed it for $200,000 more than what the taxpayer claimed, plus interest. The taxpayer promptly returned the excess amount. The IRS did not adjust the account correctly to show the correct credit or the returned refund. In the meantime, the refund statute expiration date (RSED) passed.[109] The taxpayer filed another Form 1120-X, based on a Competent Authority determination.[110] The IRS refused to process the second claim, citing the expired RSED and that the taxpayer already received an excess refund. The IRS ignored that the taxpayer returned the erroneous refund and that the Competent Authority ruling indicated

103 Data obtained from TAMIS (Oct. 1, 2015).

104 IRM 3.17.5.8, *Substantiation Process* (Aug. 31, 2015).

105 Release signed by the taxpayer dated July 24, 2015.

106 IRC § 6402. When a married couple files a joint return claiming a refund, the IRS may offset the refund to satisfy certain outstanding tax and non-tax debts belonging to one of the spouses. The non-liable spouse has a right to have a portion of the refund returned. Form 8379, *Injured Spouse Allocation*, is the form the non-liable spouse uses to claim his or her share of the refund.

107 IRM 21.4.5.1, *Erroneous Refunds Overview* (June 25, 2013), defines an erroneous refund as the receipt of any money from the IRS to which the recipient is not entitled. This definition includes all erroneous refunds regardless of taxpayer intent or whether the error that caused the erroneous refund was made by the IRS, the taxpayer, or a third party.

108 Release signed by the taxpayer dated August 5, 2015.

109 IRC § 6511(a) states the general rule that no credit or refund shall be allowed or made more than three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within two years from the time the tax was paid. If the claim for credit or refund is attributable to taxes paid or accrued to any foreign country, instead of the three-year period set by IRC § 6511(a), the taxpayer has ten years from the date prescribed by law for filing the return for the year in which those taxes were actually paid or accrued. IRC § 6511(d)(3)(A).

110 Rev. Proc. 2006-54, 2006-49 I.R.B. 1035; IRM 21.5.3.4.9, *Competent Authority Claims* (Aug. 4, 2010).

that the taxpayer's claim carried a ten-year statute of limitations. Subsequently, the IRS moved the returned refund to the excess collection account.[111] TAS repeatedly received the agreement of an IRS employee to correct the problems, only to have another employee stop the correction. Then, the IRS would not take corrective action, because the employee who made the original errors was no longer employed with the IRS, citing an IRM provision that says the person who made the error should correct the error, while disregarding the caution that the unit will act when the originating employee is "not available."[112] Once TAS issued the TAO, the IRS released the refund and fully corrected the account.[113]

- In 2012, the taxpayer contacted TAS about an IDT issue on his 2011 return. TAS worked through the issues, securing the full refund. Then, the IRS rejected the taxpayer's 2012 return. TAS again secured the full refund for the taxpayer. The taxpayer advised TAS that his 2010 refund offset to pay a debt he did not know he had, and TAS found another IDT problem. The taxpayer provided the needed documentation, and the IRS promptly adjusted the account but refused to release the refund because the RSED had passed. The IRS transferred the credit to the excess collection account from the taxpayer's account.[114] TAS argued that the refund offset from the taxpayer's timely filed 2010 return and should be moved back to 2010 with an open RSED and refunded. The IRS disagreed. TAS sought Counsel's opinion, and Counsel agreed with TAS. The IRS still refused to return the funds until after TAS issued a TAO.[115]

TAS Issues TAOs Where IRS Inaction Exacerbates Return Preparer Misconduct

In the National Taxpayer Advocate's FY 2016 Objectives Report to Congress and in previous reports, she outlined the issues surrounding the IRS's current policy on assisting victims of tax return preparer misconduct.[116] Taxpayers seek TAS assistance when they become aware of preparer misconduct, which generally only happens after the IRS:

- Reviews or audits the return;
- Disallows the incorrect deductions, withholding, or credits;
- Holds the taxpayer liable for the resulting increased tax assessment; or
- Prevents the taxpayer from obtaining the portion of the refund he or she was entitled to and did not actually receive.

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111 IRM 3.17.220.2, *Excess Collections File* (Jan. 1, 2014). Monies are removed from accounts after the refund statute of limitations expires, as well as payments that could not be applied as intended for a variety of reasons, and placed in this general account.

112 IRM 25.6.1.10.2.2.3, *Correction of Erroneous Abatement Cases by the Originating Function* (Nov. 18, 2011), which states in part, "the originator of an erroneous abatement requiring reversal must initiate the corrective action whether or not assigned to Statute… **NOTE:** The originating function is responsible for corrective actions on cases where the originator is no longer working in the area where the erroneous abatement occurred. This is regardless of whether the assessment statute has/has not expired."

113 Release signed by the taxpayer dated Sept. 10, 2015.

114 IRM 3.17.220.2, *Excess Collections File* (Jan. 1, 2014). Monies are removed from accounts after the refund statute of limitations expires, as well as payments that could not be applied as intended for a variety of reasons, and placed in this general account.

115 Release signed by the taxpayer dated Sept. 11, 2015.

116 See National Taxpayer Advocate FY 2016 Objectives Report to Congress 34-7 (Area of Focus: *The IRS Agrees It Should Issue Refunds to Victims of Return Preparer Fraud, But It Has Been Slow to Develop Necessary Procedures*); National Taxpayer Advocate FY 2015 Objectives Report to Congress 4 (Preface: *The IRS is Actively Harming Victims of Return Preparer Fraud by Delaying the Release of Refunds for Years*); National Taxpayer Advocate FY 2015 Objectives Report to Congress 22-34 (*Return Preparer Fraud: A Sad Story*). National Taxpayer Advocate 2013 Annual Report to Congress 94-102; National Taxpayer Advocate 2012 Annual Report to Congress 68-94; National Taxpayer Advocate 2011 Annual Report to Congress 420-26.

In FY 2015, TAS continued to elevate the problem, issuing 43 TAOs due to return preparer misconduct.[117] Since FY 2010, 161 TAOs for this issue have been elevated to the National Taxpayer Advocate, and 25 of these were elevated to the Commissioner.[118] Taxpayers in these cases are usually low income and depend on their refunds to meet basic living expenses.[119] Some have been waiting for years to receive their proper refunds. At this time, the IRS has not finalized the procedures, while the taxpayers continue to be harmed.

TAOs to Examination Functions

In FY 2014, TAS issued 35 TAOs to examination units in W&I and Small Business/Self-Employed (SB/SE) BODs for issues including return preparer misconduct, the EITC, audit reconsiderations, actions to complete open audits of original returns, penalty abatements, IDT, and appeal rights.[120]

EITC TAO cases involved hardships. An example follows:

- The taxpayer, who was elderly with health problems, had a disabled grown daughter. The taxpayer received Social Security benefits and worked part-time to meet basic living expenses. The taxpayer contacted TAS directly and through his Congressional representative after the IRS disallowed his dependent and the EITC, plus changed his filing status. The IRS repeatedly challenged the documents provided for proof of the daughter's disability, determining she was not a qualifying child for dependency exemption or EITC. The daughter enrolled in school, causing the IRS to determine that she was not impaired, contrary to her doctor's statement. The taxpayer explained that this was an online school with campuses in another state and that she did not physically attend a school with a campus. TAS issued a TAO with additional supporting documentation about the school attendance issue to firmly establish that she was a qualifying child. The IRS complied with the TAO to allow all items related to the taxpayer's dependent.[121]

Other examination TAO scenarios included:

- The taxpayers had a presidential memorabilia collection, which they exhibited until losing the IRC § 501(c)(3) status. The IRS audited them on issues related to the disposition of the collection. The taxpayers approached TAS, wanting aid to conclude the exam and to address concerns regarding their rights. Before coming to TAS, the taxpayers requested a copy of the examination file to assist in their appeal. The examiner told the taxpayers that they had to file a Freedom of Information Act Request to get this information, contrary to current guidance from the Privacy, Governmental Liaison and Disclosure Office. TAS issued a TAO to secure the file copy for the taxpayers, which the IRS provided.[122]

117 Data obtained from TAMIS (Oct. 1, 2015).

118 Data obtained from TAMIS (Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

119 National Taxpayer Advocate 2013 Annual Report to Congress 94-102; National Taxpayer Advocate 2012 Annual Report to Congress 68-94.

120 Data obtained from TAMIS (Oct. 1, 2015).

121 Release signed by the taxpayer dated July 31, 2015. In his last conversation with the CA, the taxpayer indicated that he did not claim his disabled daughter on the 2014 income tax return because he did not feel he could survive another audit experience, as it had negatively affected his health. He would not work with the CA to file a Form 1040X, *Amended Individual Income Tax Return*, to claim his daughter to receive the refund to which he was entitled.

122 Release signed by the taxpayers dated August 10, 2015.

- Taxpayers filed a return after an SFR assessment, and the IRS audited the return.[123] The taxpayers needed the refund for their support, as their Social Security benefits were insufficient. Without authority, one operating division of the IRS took incomplete action on the account. As a result, the function with the authority to correct it refused to act. The taxpayer was stuck between the two functions, and during this time, the refund statute expired. Then, the IRS argued that it could not issue the refund because the refund statute had expired.[124] TAS issued a TAO, and after the IRS operating division received an opinion from the Office of Chief Counsel upholding TAS's position, the IRS then corrected the account and released the refund.[125]
- A couple filed protective claims to file jointly, pending the U.S. Supreme Court's decision on the Defense of Marriage Act. Once the Court rendered its decision and the IRS published its procedures, the IRS did not process the claims. The taxpayers sought TAS's assistance, and the IRS processed the claims for three tax periods, but not the fourth. TAS issued a TAO to allow the fourth period due to the timely filed claim. The IRS issued refunds with interest for all four periods. The taxpayer received additional interest for the period of time during which the IRS delayed the resolution.[126]
- The taxpayer needed a penalty abated. He could not pay the $5,000 penalty to appeal it. His sole sources of income were his Social Security benefits and a part-time job. He filed his return, as he always had, but made a simple mistake. The IRS deemed the return frivolous.[127] The IRS refused to abate the penalty, saying the taxpayer had to pay it in full and go to court. TAS issued a TAO, citing taxpayer burden and justifiable reasons about why he did not respond to the IRS's inquiry before the penalty was assessed. The IRS abated the penalty.[128]
- After the taxpayer fully paid the prior examination assessments for three tax years, he presented additional documents that resulted in a total abatement of the exam results. The IRS refunded the overpaid tax amounts. The IRS did not properly abate the associated penalties due to an omission on the exam report. When TAS requested that the IRS follow through to abate the penalties and to release the additional refunds, the IRS stated the refund statutes had expired between the initial refund and the time of the TAS request, ignoring the fact that the claim that caused the abatement of the tax and the penalties was timely. The IRS would not consider the correction of an error without the prior examination file, which it could not locate. Yet the IRS had abated the total tax, so it had to abate the penalties imposed as a result of the abated tax, making the need for the administrative file moot. TAS issued a TAO, directing abatement of the penalties and release of the refunds. The IRS took both actions. The taxpayer received additional interest from the government that accrued during the time that the IRS delayed this action.[129]

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123 See Most Serious Problem: *Automated Substitute for Return (ASFR) Program: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*, *supra*. A substitute for return (SFR) is a return prepared for a taxpayer by the IRS when it has no record of receiving a return and has not been able to obtain one from someone who was expected to file. IRC § 6020(b) allows the IRS to prepare a return on behalf of the taxpayer based on available information. The taxpayer may reduce the SFR liability by filing an original return, reflecting allowable deductions and credits about which the IRS had no information at the time the SFR was prepared.

124 IRC § 6511.

125 Release signed by the taxpayers dated July 31, 2015.

126 Release signed by the taxpayers dated August 2, 2015.

127 IRC § 6702. A request is subject to the penalty, if any part of it "(i) is based on a position which the Secretary has identified as frivolous… or (ii) reflects a desire to delay or impede the administration of the Federal tax laws." Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous tax return. The taxpayer then has 30 days to resubmit the return without the frivolous position to avoid the penalty.

128 Release signed by the taxpayer dated August 11, 2015.

129 Release signed by the taxpayer dated August 31, 2015.

TAOs to Tax Exempt/Government Entities (TE/GE)

TE/GE cases present vitally important advocacy opportunities for TAS, both on substantive legal determinations and processing issues.[130] Tax-exempt organizations contribute religious, educational, scientific, social welfare, and other positive benefits to the public. Many of these exempt organizations (EOs) are small entities, staffed by volunteers.[131] Without the IRS's determination on the tax exemption, the entity will struggle to solicit funds from donors, who are motivated in part by the ability to deduct contributions made to an approved IRC § 501(c)(3) tax-exempt entity. While some EOs under IRC § 501(c) may operate without the need to seek an IRS determination, it is TAS's experience with IRC § 501(c) cases that many entities are reluctant to operate without formal IRS approval.[132]

In FY 2015, TAS did not issue any TAOs to the TE/GE operating division.[133] TAS's FY 2015 case receipts involving applications for exempt status decreased by about 74 percent from FY 2014.[134] Nearly 31 percent of the FY 2015 cases met economic burden criteria, and 55 percent were congressional referrals.[135] The decline in EO cases may be attributed to the introduction of the abbreviated Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. Taxpayers have received the IRC § 501(c)(3) exemption approval more quickly, causing fewer to seek TAS's assistance. However, while this expedited process for obtaining tax exempt status has reduced TAS EO casework, it has created a significant compliance concern.[136] Overall, TAS provided some form of relief in 83 percent of cases (1,025 organizations) seeking to resolve exempt status application issues in FY 2015.[137] TAS resolved these cases in an average of 78 days, an improvement of over nine percent from FY 2014.[138]

TAOs on Collection Issues

In FY 2015, levy issues were the fourth largest source of TAS economic burden receipts, as shown in Figure 4.1.7.[139] If the IRS does not act quickly in these cases, the taxpayer may experience even greater financial harm. TAS issued 21 TAOs on levy cases in FY 2015. The IRS complied with 17 of the 21 TAOs

130 *See* Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013); National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013).

131 *See* National Taxpayer Advocate 2009 Annual Report to Congress 287, addressing the need for targeted research and increased collaboration to meet the needs of tax EOs; National Taxpayer Advocate 2005 Annual Report to Congress 293, discussing inadequate service to EOs resulting in unnecessary penalties; National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013).

132 Some organizations are not required to obtain formal recognition of tax-exempt status from the IRS but may obtain such recognition by submitting IRS Form 1024, *Application for Recognition of Exemption Under Section 501(a)*. National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* 3 (June 30, 2013), available at http://www.taxpayeradvocate.irs.gov/2014ObjectivesReport/Special-Report.

133 Data obtained from TAMIS (Oct. 1, 2015).

134 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

135 Data obtained from TAMIS (Oct. 1, 2015).

136 *See* Most Serious Problem: *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*, *supra*; Vol. 2: *Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, *infra*, noting that in a representative sample of organizations whose Form 1023-EZ application was approved, 37 percent did not meet the requirements for exempt status as a section 501(c)(3) organization as a matter of law.

137 Data obtained from TAMIS (Oct. 1, 2015).

138 Data obtained from TAMIS (Oct. 1, 2014; Oct. 1, 2015).

139 Data obtained from TAMIS (Oct. 1, 2015).

for levies in FY 2015.[140] Seventeen of the 21 levy-related TAOs requested the return of levy proceeds for taxpayers experiencing economic burden. TAS rescinded two and is processing two more. An example is:

- The IRS assessed a frivolous filer penalty based on a return filed under the taxpayer's SSN by an identity thief.[141] The taxpayer learned this when the IRS levied her Social Security benefits. The taxpayer immediately requested a return of the proceeds, but the IRS did not act on the request. The taxpayer then requested penalty abatement and received an approval letter from the IRS. After repeated failed attempts to get the account corrected and the levy proceeds returned, the taxpayer came to TAS. The IRS unit that approved the penalty abatement did not have the authority to do so. The correct unit did not agree with the decision, insisting the taxpayer had to full pay the penalty and pursue court action. TAS argued that the taxpayer should not be burdened, when she did not file the return that gave rise to the penalty. TAS issued a TAO. The IRS abated the penalty and returned the levy proceeds.[142]

TAS issued 25 TAOs to Collection functions for other issues, including:

- A taxpayer, who was approximately 50 years old, contacted TAS seeking release of a wage levy as well as a proposed levy on his Thrift Savings Plan (TSP) account. The TSP is a retirement savings and investment plan for federal employees and members of the uniformed services.[143] A recent change in the law now allows the IRS to take the entire contents of a TSP account, regardless of whether the taxpayer has a present right to withdraw from the account.[144] Under current internal guidance, the IRS is required to consider three issues before levying a retirement account: the availability of other assets, whether the taxpayer's conduct is flagrant, and whether the taxpayer currently relies (or will rely in the near future) on the funds in the retirement account.[145] Prior to coming to TAS, the taxpayer submitted an installment agreement, which remained unprocessed for almost one year because the IRS claimed that it had not been received. It was during this time that the IRS issued a levy on the taxpayer's wages and was in the process of levying his retirement account.[146] TAS issued a TAO seeking a release of the wage levy and return of levy proceeds, requesting the IRS forebear issuing a levy on the retirement account, and challenging the sufficiency of the pre-levy analysis required for the retirement levy, particularly in regard to the determination of flagrant conduct. In addition as part of the TAO, TAS ordered the IRS to consider an offer in compromise submitted by the taxpayer. The IRS Deputy Commissioner rescinded the TAO. As a result, the IRS did not release the wage levy and, in addition, levied the taxpayer's entire TSP account. The wage levy had been so severe that the taxpayer was paying his basic living expenses by credit card. Since the proceeds from the levy on the TSP account did not fully pay his tax liability, the taxpayer has subsequently entered into an installment agreement to satisfy the remaining balance of liability, and accordingly, the IRS has released the wage levy. He now has approximately a

140 Data obtained from TAMIS (Oct. 1, 2015).

141 IRC § 6702. A request is subject to the penalty, if any part of it "(i) is based on a position which the Secretary has identified as frivolous… or (ii) reflects a desire to delay or impede the administration of the Federal tax laws." Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous tax return. The taxpayer then has 30 days to resubmit the return without the frivolous position to avoid the penalty.

142 Release signed by the taxpayer dated August 3, 2015.

143 TSP was established by Congress in the Federal Employees' Retirement System Act of 1986 and offers the same types of savings and tax benefits that many private corporations offer their employees under 401(k) plans

144 5 U.S.C. § 8437 (e)(3).

145 IRM 5.11.6.2(4)-(7), *Funds in Pension or Retirement Plans* (Sept. 26,2014).

146 The IRS is prohibited from issuing a levy while an installment agreement is pending or in effect. IRC SS 6331(k).

decade to replenish his retirement account and may face financial instability in his retirement years. Last, the taxpayer incurred a tax liability since the distribution qualifies as gross income.[147]

- Taxpayers filed an OIC in 2012 for business taxes but withdrew it. They filed another OIC in 2014 for individual taxes owed. The LTA issued a TAO to expedite the OIC process due to the taxpayers' circumstances and to reduce the time the taxpayers had to wait for the IRS to assign the offer. The IRS complied by assigning and working the OIC.[148]
- Divorced spouses agreed to quit claim their interests in their respective houses to the other, so each alone had interest in their own properties. While the TAS taxpayer complied with the agreement, the former spouse did not. In the meantime, the former spouse who owed employment taxes passed away. The NFTL attached to the TAS taxpayer's property, because the decedent was still on the deed. Upon the death of the former spouse, his interest was extinguished. Furthermore, based on state law and the divorce decree, TAS showed that the decedent had no interest in the property. The LTA argued that, based on the ownership language in the deed, state law, and the divorce decree, the TAS taxpayer solely owned her home by virtue of the former spouse's death. The IRS could not place a lien or take any other action against her. The IRS did not agree, and TAS issued a TAO. Counsel concurred with TAS, at which point the IRS withdrew the lien and ceased action to collect the former husband's debt from the TAS taxpayer.[149]
- An identity thief filed a return claiming the First-Time Homebuyer Credit for which the IRS held the TAS taxpayer liable. The IRS filed a lien due to the IDT balance due, which was affecting the TAS taxpayer's credit. TAS identified two additional IDT years about which the taxpayer was unaware. TAS followed the IDT procedures to have all three years corrected. The IRS corrected the two most recent years but would not correct the tax year for which the taxpayer sought help. The LTA asked that the IRS look at the facts and the documents, rather than citing IRM procedures that were irrelevant due to the IDT facet. For example, the IRS insisted that it issued the statutory notice of deficiency to the address of record, which was from the identity thief's return, not the TAS taxpayer's return. TAS proved the taxpayer did not file the return. TAS issued a TAO to correct the account and release the refunds after reversing the offsets. The IRS complied. Rather than waiting for the exam decision, TAS sent an OAR for a lien withdrawal (citing the IDT), which was also successful.[150]

TAOs to Appeals

TAS issued seven TAOs during FY 2015 to the Office of Appeals, and Appeals complied with one. TAS rescinded one at the taxpayer's request; five TAOs remain in process.

TAS has worked cooperatively with Appeals in many areas, primarily through the TAS-Appeals Advisory Board (TAAB), made up of senior leadership from both TAS and Appeals. For example, Appeals personnel briefed the TAAB on the Appeals Judicial Approach and Culture (AJAC) initiative.[151] TAS recorded an awareness video presentation about AJAC in May 2015, which it will require all CAs to view during the FY 2016 continuing education cycle. As stated previously, the National Taxpayer Advocate has

147 IRC § 408(d). Release signed by the taxpayer dated December 17, 2015.

148 Release signed by the taxpayer dated August 10, 2015.

149 Release signed by the taxpayer dated July 27, 2015.

150 Release signed by the taxpayer dated July 25, 2015.

151 *See* Most Serious Problem: Appeals: *The Appeals Judicial Approach and Culture Project is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*, *supra*.

concerns about the AJAC initiative.[152] Additionally, the National Taxpayer Advocate is concerned that the Collection Appeals Program (CAP) provides inadequate review and insufficient protections for taxpayers facing collection actions.[153]

Congressional Case Trends

Taxpayers often turn to their congressional representatives when faced with IRS issues. The congressional representatives refer these taxpayers to TAS, which is responsible for responding to tax account inquiries sent to the IRS by members of Congress. Figure 4.1.17 reflects the total congressional case receipts and total TAS receipts from other contacts.

FIGURE 4.1.17[154]

TAS Congressional Receipts and Total Case Receipts, FYs 2012–2015

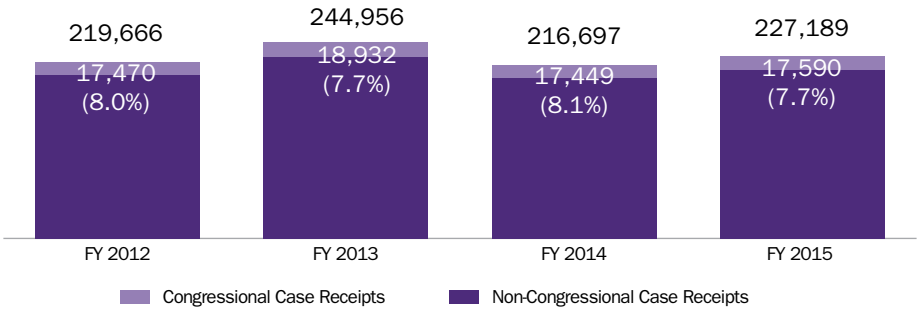

Figure 4.1.18 shows the top 10 PCICs causing taxpayers to seek the assistance of their congressional representatives. IDT receipts increased by 69 percent between FY 2014 and FY 2015 and Pre-Refund Wage Verification Holds increased by 21 percent. These mirror the top two issues for all receipts. Applications for Exempt Status cases from congressional referrals declined by about 80 percent, which was similar to the decline in TAS cases overall for this issue.[155]

152 See Most Serious Problem: *Appeals: The Appeals Judicial Approach and Culture Project is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*, *supra*.

153 See Most Serious Problem: *Collection Appeals Program (CAP): The CAP Provides Inadequate Review and Insufficient Protections for Taxpayers Facing Collection Actions*, *supra*.

154 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

155 PCIC 460 Application for Exempt Status cases from all sources, including congressional referrals, were 3,589 in FY 2014 and 931 in FY 2015, which was a decline of about 74 percent.

FIGURE 4.1.18, TAS Top Ten Congressional Receipts by PCIC, FYs 2014–2015[156]

Rank	Issue Category	FY 2014	FY 2015	Percent Change
1	Identity Theft	1,998	3,378	69.1%
2	Pre-Refund Wage Verification Hold	1,298	1,571	21.0%
3	Processing Original Return	880	871	-1.0%
4	Processing Amended Return	699	838	19.9%
5	Failure to File Penalty (FTF)/ Failure to Pay (FTP)	507	564	11.2%
6	Installment Agreements	423	528	24.8%
7	Levies	530	517	-2.5%
8	Application for Exempt Status (F.1023/1024)	2,645	512	-80.6%
9	Transcript Requests	427	502	17.6%
10	Other Refund Inquiries or Issues	401	417	4.0%
	Other Issues	7,641	7,892	3.3%
Total Congressional Receipts		**17,449**	**17,590**	**0.8%**

TAS continued to work many issues in FY 2015 after direct contact by taxpayers, their representatives' contacts, IRS employees' referrals, and congressional representatives' referrals. TAS acted to expedite the outcome of all cases but particularly those presented with economic burdens for the taxpayers.

156 Data obtained from TAMIS (Oct. 1, 2015).

Top 25 Case Advocacy Issues for FY 2015 by TAMIS* Receipts

Issue Code	Description	FY 2015 Case Receipts
425	Identity Theft	56,174
45	Pre-Refund Wage Verification Hold	40,633
330	Processing Amended Return	11,847
63x - 640	Open Earned Income Tax Credit (EITC) Audits, Certification, Reconsideration, Recertification	10,880
71x	Levies (Including Federal Payment Levy Program)	7,977
310	Processing Original Return	7,148
620	Reconsideration of Audits and Substitute for Return under IRC § 6020(b)	6,723
315	Unpostable or Rejected Returns	6,057
40	Returned or Stopped Refunds	4,612
340	Injured Spouse Claim	4,604
75x	Installment Agreements	4,118
610	Open Audit, Non-EITC	3,591
60	IRS Offset	3,442
920	Affordable Care Act (ACA) Health Insurance Premium Tax Credit for Individuals under IRC § 36B	3,318
90	Other Refund Inquiries or Issues	3,314
670	Closed Automated Underreporter	3,300
72x	Liens	3,051
520	Failure to File Penalty (FTF) or Failure to Pay (FTP)	2,578
10	Lost or Stolen Refunds	2,110
210	Missing or Incorrect Payments	1,994
320	Math Error	1,921
790	Other Collection Issues	1,907
660	Open Automated Underreporter	1,884
151	Transcript Requests	1,862
740	Unable to Pay (Currently Not Collectible (CNC))	1,854
Total Top 25 Receipts		**196,899**
Total TAS Receipts		**227,189**

* Taxpayer Advocate Management Information System

Glossary of Acronyms

Acronym	Definition
AARS	Appeals Account Resolution Specialist
ABA	American Bar Association
ABLE	Achieving a Better Life Experience
ACA	Affordable Care Act
ACDS	Appeals Centralized Database System
ACE	Automated Correspondence Exam
ACS	Automated Collection System
ACTC	Additional Child Tax Credit
ADR	Alternative Dispute Resolution *or* Address Research System
AEITC	Advanced Earned Income Tax Credit
AGI	Adjusted Gross Income
AIC	Akaike Information Criteria
AICPA	American Institute of Certified Public Accountants
AIMS	Audit Information Management System
AIS	Automated Insolvency System
AJAC	Appeals Judicial Approach and Culture
ALE	Allowable Living Expenses or Applicable Large Employers
ALS	Automated Lien System
AM	Accounts Management
AMS	Accounts Management System
AMT	Alternative Minimum Tax
AO/SO	Appeals or Settlement Officer
AOIC	Automated Offer In Compromise
AOTC	American Opportunity Tax Credit
APA	Administrative Procedure Act or Advance Pricing Agreement
APTC	Advance Premium Tax Credit
AQC	Automated Questionable Credits
AQR	Automated Questionable Refund
ARC	Annual Report to Congress
ARDI	Accounts Receivable Dollar Inventory
ASA	Average Speed of Answer
ASED	Assessment Statute Expiration Date
ASFR	Automated Substitute for Return
ATAO	Application for Taxpayer Assistance Order
ATE	Average Treatment Effect
ATT	Average Treatment Effect on the Treated

Acronym	Definition
AUR	Automated Underreporter
BAPCPA	Bankruptcy Abuse Prevention and Consumer Protection Act (of 2005)
BMF	Business Master File
BOD	Business Operating Division
BPMS	Business Performance Management System
BPR	Business Performance Review
BRRM	Business Rules and Requirements Management
BSA	Bank Secrecy Act
CAA	Certifying Acceptance Agent
CAP	Collection Appeals Program or Compliance Assurance Process
CAR	Case Activity Record
CAS	Customer Account Services
CC	Chief Counsel (Office of)
CCA	Chief Counsel Advice
CCDM	Chief Counsel Directives Manual
CCH	Commerce Clearing House
CCI	Centralized Case Intake
CDP	Collection Due Process
CDW	Compliance Data Warehouse
CFO	Chief Financial Officer (Office of)
CI	Criminal Investigation (Division)
CIS	Correspondence Imaging System or Collection Information Statement
CMS	Centers for Medicare and Medicaid Services
CNC	Currently Not Collectible
CONOPS	Concept of Operations
CP	Computer Paragraph
CPA	Certified Public Accountant
CPE	Continuing Professional Education
CPI	Consumer Price Index
CPS	Collection Process Study
CSED	Collection Statute Expiration Date
CSR	Customer Service Representative
CTC	Child Tax Credit
CY	Calendar Year
DCI	Data Collection Instrument
DD	Difference-in-Differences (estimator)

Acronym	Definition
DDb	Dependent Database
DHS	Department of Homeland Security
DIF	Discriminant Income Function
DNTA	Deputy National Taxpayer Advocate
DOJ	Department of Justice
DOMA	Defense of Marriage Act
DPC	Designated Payment Code
EA	Enrolled Agent
EAC	Examination Activity Class
EAR	Electronic Account Resolution
EB	Economic Burden
EBRI	Employee Benefits Retirement Institute
EFDS	Electronic Fraud Detection System
EFIN	Electronic Filing Identification Number
EFS	Enterprise Fax Storage
EH	Equivalent Hearing
EIC	Earned Income Credit
EIN	Employer Identification Number
EITC	Earned Income Tax Credit
EO	Exempt Organization
EOMF	Exempt Organization Master File
EP	Employee Plans
EQ	Embedded Quality
EQRS	Embedded Quality Review System
ERCPC	Earned Income Tax Credit and Refundable Credits Policy and Coordination
ERIS	Enforcement Revenue Information System
ERISA	Employee Retirement Income Security Act
ERO	Electronic Return Originator
ERSA	Employee Retirement Savings Account
ESC	Executive Steering Committee
ESI	Electronically Stored Information
ESL	English as a Second Language
ESRP	Employer Shared Responsibility Payment
ETA	Effective Tax Administration
ETLA	Electronic Tax Law Assistance
FAC	Federal Advisory Committee
FAQ	Frequently Asked Question
FATCA	Foreign Account Tax Compliance Act

Acronym	Definition
FBAR	Report of Foreign Bank and Financial Accounts
FC	Field Collection
FCA	False Claim Act
FCR	Federal Case Registry
FDC	Fraud Detection Center
FDIC	Federal Deposit Insurance Corporation
FERA	Fraud Enforcement and Recovery Act (of 2009)
FFI	Foreign Financial Institution
FIRPTA	Foreign Investment in Real Property Tax Act
FOIA	Freedom of Information Act
FPL	Federal Poverty Level or Line
FPLP	Federal Payment Levy Program
FRA	Federal Records Act
FRCP	Federal Rules of Civil Procedure
FRP	Frivolous Return Program
FS	Filing Season
FTE	Full-Time Equivalent
FTF	Failure To File
FTHBC	First-Time Homebuyer Credit
FTL	Federal Tax Lien
FTP	Failure To Pay
FY	Fiscal Year
FYE	Fiscal Year Ending
GAO	Government Accountability Office *or* General Accounting Office
GDP	Gross Domestic Product
GLD	Governmental Liaison and Disclosure
GE	Government Entities
GS	General Schedule
HCTC	Health Coverage Tax Credit
HERCA	Health Care & Education Reconciliation Act of 2010
HHI	Household Income
HHS	Health and Human Services
HMRC	Her Majesty's Revenue and Customs
IA	Installment Agreement
IBC	International Business Compliance
ICE	Initial Claim Evaluation
ICS	Integrated Collection System
IDR	Information Document Request

Acronym	Definition
IDRM	Information Reporting and Document Matching
IDRS	Integrated Data Retrieval System
IDT	Identity Theft
IDTVA	Identity Theft Victim Assistance
IFC	International Finance Corporation
IGM	Interim Guidance Memorandum
IIC	International Individual Compliance
IMD	Internal Management Document
IMF	Individual Master File
IOAA	Independent Offices Appropriation Act (of 1952)
IP	Internet Protocol or Identity Protection
IP PIN	Identity Protection Personal Identification Number
IPO	ITIN Program Office
IPSU	Identity Protection Specialized Unit
IRA	Individual Retirement Account
IRB	Internal Revenue Bulletin
IRC	Internal Revenue Code
IRDM	Information Reporting Document Matching
IRM	Internal Revenue Manual
IRMF	Information Returns Master File
IRP	Information Returns Processing
IRPAC	Information Reporting Program Advisory Committee
IRS	Internal Revenue Service
IRSN	Internal Revenue Service Number
IRTF	Individual Returns Transaction File
ISRP	Individual Shared Responsibility Payment
IT	Information Technology
ITA	Interactive Tax Assistance
ITAR	Identity Theft Assistance Request
ITG	Indian Tribal Government
ITIN	Individual Taxpayer Identification Number
IVES	Income Verification Express Service
IVO	Integrity & Verification Operations
IWV	Income Wage Verification
JCT	Joint Committee on Taxation
JOC	Joint Operations Center
LB&I	Large Business and International Operating Division
LEM	Law Enforcement Manual

Acronym	Definition
LEP	Limited English Proficiency
LIF	Low Income Filter
LITC	Low Income Taxpayer Clinic
LLC	Limited Liability Company
LLP	Limited Liability Partnership
LOS	Level of Service
LP	Limited Partnership
LR	Legislative Recommendation
LTA	Local Taxpayer Advocate
MAGI	Modified Adjusted Gross Income
MEA	Math Error Authority
MEC	Minimal Essential Coverage
MFJ	Married Filing Joint
MFT	Master File Transaction
MLI	Most Litigated Issue
MOI	Memo of Interview
MSP	Most Serious Problem
NAEA	National Association of Enrolled Agents
NC	No-tax-change (experimental group)
NEH	Non-Economic Hardship
NES	Needs Enhancement Support
NFTL	Notice of Federal Tax Lien
NOD	Notice of Deficiency
NPL	National Public Liaison
NPRM	Notice of Proposed Rule Making
NQR	National Quality Review
NQRS	National Quality Review System
NRP	National Research Program
NTA	National Taxpayer Advocate
OAR	Operations Assistance Request
OCA	Office of Compliance Analytics
OD	Operating Division
OECD	Organisation for Economic Co-Operation and Development
OIC	Offer in Compromise
OLS	(IRS Office of) Online Services
OMB	Office of Management and Budget
OPERA	Office of Program Evaluation, Research, & Analysis
OPI	Office of Penalty and Interest Administration *or* Over the Phone Interpreter

Acronym	Definition
OPM	Office of Personnel Management
OPR	Office of Professional Responsibility
OSI	Office of Servicewide Interest
OSP	Office of Servicewide Penalties or Office of Special Penalties
OTA	Office of Tax Analysis
OTC	Office of Taxpayer Correspondence
OTP	Office of Tax Policy
OUO	Official Use Only
OVC	Office for Victims of Crime
OVCI	Offshore Voluntary Compliance Initiative
OVD	Offshore Voluntary Disclosure
OVDI	Offshore Voluntary Disclosure Initiative
OVDP	Offshore Voluntary Disclosure Program
PAC	Program Action Cases
PC	Positive-tax-change (experimental group)
PCIC	Primary Core Issue Code
PFA	Pre-Filing Agreement
PGLD	Privacy, Governmental Liaison and Disclosure (Office of)
PIA	Privacy Impact Assessment
PIC	Primary Issue Code
PLR	Private Letter Ruling
PMTA	Program Manager Technical Advice or Assistance
POA	Power Of Attorney
PPS	Practitioner Priority Service
PTC	Premium Tax Credit
PTIN	Preparer Tax Identification Number
PTSD	Post-Traumatic Stress Disorder
PY	Processing Year
QRP	Questionable Refund Program
RA	Revenue Agent *or* Reporting Agent
RAS	(Office of) Research, Analysis and Statistics
RCA	Reasonable Cause Assistant or Refundable Credits Administration
RCP	Reasonable Collection Potential
RDD	Random-Digit Dialed
RIA	Research Institute of America
RICS	Return Integrity and Correspondence Services
RO	Revenue Officer
ROI	Return on Investment

Acronym	Definition
RPO	Return Preparer Office
RPP	Return Preparer Program
RPS	Revenue Protection Strategy
RRA 98	Internal Revenue Service Restructuring and Reform Act of 1998
RRP	Return Review Program
RSED	Refund Statute Expiration Date
S/E	Self-Employed
SA	Systemic Advocacy
SAMS	Systemic Advocacy Management System
SB/SE	Small Business/Self-Employed Operating Division
SBHCTC	Small Business Health Care Tax Credit
SCIC	Secondary Core Issue Code
SEP	Special Enforcement Program
SERP	Servicewide Electronic Research Program
SFR	Substitute for Return
SIFMA	Securities Industry and Financial Markets Association
SL	Stakeholder Liaison
SLA	Service Level Agreement
SLCSP	Second Lowest Cost Silver Plan
SMS	Secure Messaging System
SNOD	Statutory Notice of Deficiency
SO	Settlement Officer
SOI	Statistics of Income
SP	Submission Processing
SPC	Submission Processing Center(s)
SPDER	Office of Servicewide Policy, Directives, and Electronic Research
SPEC	Stakeholder Partnerships, Education & Communication
SRP	Shared Responsibility Payment
SSDI	Social Security Disability Insurance
SSN	Social Security Number
STARS	Structured Trust Advantaged Repackaged Securities
TAB	Taxpayer Assistance Blueprint
TAC	Taxpayer Assistance Center
TAD	Taxpayer Advocate Directive
TAMIS	Taxpayer Advocate Management Information System

Acronym	Definition
TAMRA	Technical and Miscellaneous Revenue Act (of 1988)
TAO	Taxpayer Assistance Order
TAP	Taxpayer Advocacy Panel
TARD	Taxpayer Advocate Received Date
TAS	Taxpayer Advocate Service
TASIS	Taxpayer Advocate Service Integrated System
TBOR	Taxpayer Bill of Rights
TC	Transaction Code
TCE	Tax Counseling for the Elderly
TCS	Tax Computation Specialists
TD	Treasury Developed (form)
TDA	Taxpayer Delinquent Account
TDC	Taxpayer Digital Communications
TE	Tax Examiner *or* Tax Exempt
TE/GE	Tax Exempt & Government Entities Operating Division
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
TERC	Total Enforcement Revenue Collected
TFRP	Trust Fund Recovery Penalty
TGR	Total Gross Receipts
TIGTA	Treasury Inspector General for Tax Administration

Acronym	Definition
TIN	Taxpayer Identification Number
TIPRA	Tax Increase Prevention and Reconciliation Act (of 2005)
TMP	TIN Matching Program
TPC	Third Party Contact
TPI	Total Positive Income
TPP	Third-Party Payer *or* Taxpayer Protection Program
TPPA	Third Party Payroll Agent
TRCAT	Taxpayer Service Returns Processing Category
TSP	Thrift Savings Plan
TY	Tax Year
UK	United Kingdom
URP	Underreporter
VITA	Volunteer Income Tax Assistance
VOIP	Voice Over Internet Protocol
VSD	Virtual Service Delivery
W&I	Wage and Investment Operating Division
WIRA	Wage and Investment Research & Analysis
WO	Whistleblower Office
YTD	Year to Date

TABLE 1 Accuracy-Related Penalty Under IRC §§ 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But not Sole Proprietorships)			
Al-Soufi v. Comm'r, T.C. Memo. 2015-68	6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith	Yes	IRS
Ambrosius v. Comm'r, T.C. Memo. 2014-126	6662(b)(2) - Penalty for substantial understatement of income tax applies provisionally; failure to argue reasonable cause and good faith	Yes	IRS
Baker v. Comm'r, T.C. Summ. Op. 2014-57	6662(b)(2) - TP acted with reasonable cause and in good faith	Yes	TP
Baur v. Comm'r, T.C. Memo. 2014-117	6662(b)(2) - Penalty for substantial understatement of income tax applies provisionally; failure to argue reasonable cause and good faith	Yes	IRS
Becker v. Comm'r, T.C. Summ. Op. 2015-2	6662(b)(1) - TP negligent in preparing the return; failure to establish reasonable cause or good faith	Yes	IRS
Brinkley v. Comm'r, T.C. Memo. 2014-227, *appeal docketed*, No. 15-60144 (5th Cir. Mar. 2, 2015)	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Burrell v. Comm'r, T.C. Memo. 2014-217	6662(b)(1) - TP negligent in failing to maintain records and erroneously claiming deductions; failure to present evidence on reasonable cause and good faith reliance on return preparer	No	IRS
Cortes v. Comm'r, T.C. Memo. 2014-181, *appeal docketed*, No. 15-71129 (9th Cir. Apr. 13, 2015)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Dabney v. Comm'r, T.C. Memo. 2014-108	6662(b)(1), (2) - TPs (H&W) acted with reasonable cause and in good faith	Yes	TP
Duncan v. Comm'r, T.C. Summ. Op. 2014-56	6662(b)(1) - TP negligent in failing to report income and in preparing the return; failure to argue reasonable cause and good faith	Yes	IRS
English v. Comm'r, T.C. Summ. Op. 2014-66	6662(b)(2) - TPs (H & W) acted with reasonable cause and good faith reliance on tax professional	Yes	TP
Evans v. Comm'r, T.C. Memo. 2015-12	6662(b)(1) - TPs (H&W) acted with reasonable cause and in good faith reliance on tax professional	No	TP
Farahani v. Comm'r, T.C. Memo. 2014-111	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Howard v. Comm'r, T.C. Memo. 2015-38	6662(b)(1), (2) - TP acted with reasonable cause and good faith regarding unreimbursed travel expenses; however, penalty for substantial understatement of income tax applies provisionally for remaining unreimbursed employee business expenses and traffic ticket	Yes	Split
Hughes v. Comm'r, T.C. Memo. 2015-89	6662(b)(1), (2) - IRS failed to present evidence of negligence; penalty for substantial understatement of income tax applies provisionally for previously settled issues; failure to establish reasonable cause and good faith	No	Split
Iglicki v. Comm'r, T.C. Memo. 2015-80	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Koriakos v. Comm'r, T.C. Summ. Op. 2014-70	6662(b)(2) - Penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith	Yes	IRS
Kunkel v. Comm'r, T.C. Memo. 2015-71	6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith	Yes	IRS

TABLE 1: Accuracy-Related Penalty Under IRC §§ 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Lain v. Comm'r, T.C. Summ. Op. 2015-5	6662(b)(1) - TPs (H&W) acted with reasonable cause and in good faith	Yes	TP
Longino v. Comm'r, 593 F. App'x 965 (11th Cir. 2014), *aff'g* T.C. Memo. 2013-80	6662(b)(1) - TP negligent in failing to maintain records; failure to present evidence of reasonable cause and good faith	Yes	IRS
McBride v. Comm'r, T.C. Memo. 2015-6	6662(b)(2) - IRS failed to argue for accuracy based penalty	Yes	TP
McCarty v. Comm'r, T.C. Summ. Op. 2014-81	6662(b)(1), (2) - IRS failed to present evidence of negligence; TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
McKnight v. Comm'r, T.C. Memo. 2015-47	6662(b)(2) - TPs substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Miller v. Comm'r, T.C. Summ. Op. 2014-74	6662(b)(1), (2) - TP acted with reasonable cause and in good faith reliance on tax professional	No	TP
Nichols, U.S. v., 115 A.F.T.R.2d (RIA) 1971 (E.D. Wash. 2015)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to argue reasonable cause and good faith	No	IRS
Peery v. Comm'r, T.C. Memo. 2014-151	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Peters, U.S. v., 113 A.F.T.R.2d (RIA) 2501 (E.D. Mo. 2014)	6662(b)(2) - TPs (H&W) substantially understated income tax	No	IRS
Resnik v. Comm'r, T.C. Summ. Op. 2015-11	6662(b)(2) - TP substantially understated income tax; failure to argue reasonable cause and good faith	No	IRS
Rogers v. Comm'r, 783 F.3d 320 (D.C. Cir. 2015), *aff'g and remanding in part*, T.C. Memo. 2013-77, *petition for cert. filed*, No. 15-286 (Sept. 8, 2015)	6662(b)(1) - TPs (H&W) negligent in failing to report income; failure to establish reasonable cause and good faith	Yes	IRS
Rublowsky v. Comm'r, T.C. Summ. Op. 2014-51	6662(b)(2) - TP acted with reasonable cause and in good faith	Yes	TP
Salmonson v. Comm'r, T.C. Memo. 2014-244	6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith	Yes	IRS
Schmidt v. Comm'r, T.C. Memo. 2014-159	6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith	No	TP
Smith v. Comm'r, T.C. Memo. 2014-203	6662(b)(1) - TP negligent in erroneously claiming deductions; failure to present evidence on reasonable cause and good faith	Yes	IRS
Sullivan v. Comm'r, T.C. Summ. Op. 2014-89	6662(b)(1), (2) - TP acted with reasonable cause and in good faith	Yes	TP
Thomas-Kozak v. Comm'r, T.C. Summ. Op. 2014-104	6662(b)(1), (2) - TP acted with reasonable cause regarding medical expense deduction; TP was negligent in failing to maintain records for remaining deductions; penalty for substantial understatement of income tax applies provisionally, excluding the medical expense deduction	No	Split
Wish v. Comm'r, T.C. Summ. Op. 2015-25	6662(b)(2) - No substantial understatement of income tax; TP acted with reasonable cause and in good faith	Yes	TP
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedule C, E, F)			
Agugo v. Comm'r, T.C. Summ. Op. 2014-60	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional	Yes	IRS
Alfaro v. Comm'r, T.C. Summ. Op. 2014-54	6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith	Yes	TP
Alubunkudi v. Comm'r, T.C. Summ. Op. 2014-97	6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records; penalty for substantial understatement of income tax applies provisionally; failure to argue reasonable cause and good faith	Yes	IRS

TABLE 1: Accuracy-Related Penalty Under IRC §§ 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Anyanwu v. Comm'r, T.C. Memo. 2014-123	6662(b)(1), (2) - TP negligent in failing to maintain records and in preparing the return; penalty for substantial understatement of income tax applies provisionally; failure to present evidence on reasonable cause and good faith	Yes	IRS
Ballard-Bey v. Comm'r, T.C. Summ. Op. 2014-62	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Barnes Grp., Inc. & Subsidiaries v. Comm'r, 593 F. App'x 7 (2d Cir. 2014), *aff'g* T.C. Memo. 2013-109	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Bogner v. Comm'r, T.C. Summ. Op. 2014-53	6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records; TPs substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Boring v. Comm'r, T.C. Summ. Op. 2014-105	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Briley v. Comm'r, T.C. Memo. 2014-114, *appeal docketed*, No. 15-1461 (4th Cir. Apr. 29, 2015)	6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith	Yes	IRS
Bronson v. Comm'r, 591 F. App'x 625 (9th Cir. 2015), *aff'g* T.C. Memo. 2012-17	6662(b)(2) - TPs (H & W) substantially understated income tax; failure to present evidence on reasonable cause and good faith	Yes	IRS
Brown v. Comm'r, T.C. Memo. 2014-167, *appeal docketed*, No. 15-3033 (2d Cir. Sept. 28, 2015)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to argue reasonable cause and good faith	No	IRS
Burke v. Comm'r, T.C. Summ. Op. 2015-24	6662(b)(1) - TP negligent in failing to maintain records; failure to present evidence on reasonable cause and good faith	Yes	IRS
Chai v. Comm'r, T.C. Memo. 2015-42, *appeal docketed*, No. 15-1653 (2d Cir. May 19, 2015)	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Cherizol v. Comm'r, T.C. Memo. 2014-119	6662(b)(2) - TP failed to address issue of accuracy based penalty; failure to argue reasonable cause and good faith	Yes	IRS
Coastal Heart Med. Grp., Inc. v. Comm'r, T.C. Memo. 2015-84	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Coburn v. Comm'r, T.C. Memo. 2014-113	6662(b)(1), (2) - TP negligent in failing to maintain records; penalty for substantial understatement of income tax applies provisionally; failure to present evidence on reasonable cause and good faith reliance on tax professional	No	IRS
Cooper v. Comm'r, 143 T.C. 194 (2014), *appeal docketed*, No. 15-70863 (9th Cir. Mar. 20, 2015)	6662(b)(1), (2) - TPs (H&W) negligent in preparing the return; penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith reliance on tax professional	No	IRS
Djoshabeh v. Comm'r, T.C. Summ. Op. 2014-58	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Duong v. Comm'r, T.C. Memo. 2015-90	6662(b)(1) - TPs (business partners) negligent in failing to maintain records; failure to present evidence on reasonable cause and good faith	Yes	IRS
Engstrom, Lipscomb & Lack, APC v. Comm'r, T.C. Memo. 2014-221, *appeal docketed*, No. 15-70591 (9th Cir. Feb. 26, 2015)	6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith	No	IRS
Evans v. Comm'r, T.C. Memo. 2014-237	6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith reliance on tax professional	No	TP
Fargo v. Comm'r, T.C. Memo. 2015-96,	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS

Case Citation	Issue(s)	*Pro Se*	Decision
Flores v. Comm'r, T.C. Memo. 2015-9	6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to present evidence on reasonable cause and good faith	Yes	IRS
Gardner v. Comm'r, T.C. Memo. 2014-148	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith reliance on a tax professional	No	IRS
Graham v. Comm'r, T.C. Summ. Op. 2014-79	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Hall v. Comm'r, T.C. Memo. 2014-171	6662(b)(1) - TPs (H&W) negligent in failing to maintain records and erroneously claiming deductions; failure to establish reasonable cause and good faith reliance on a tax professional	Yes	IRS
Hillman v. Comm'r, T.C. Memo. 2014-250	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Holden v. Comm'r, T.C. Memo. 2015-83	6662(b)(1), (2) - TP negligent in failing to maintain records and erroneously claiming deductions; penalty for substantial understatement of income tax applies provisionally; failure to present evidence on reasonable cause and good faith	No	IRS
Hunter v. Comm'r, T.C. Memo. 2014-164	6662(b)(2) - TP substantially understated income tax; failure to present evidence on reasonable cause and good faith	Yes	IRS
Jackson v. Comm'r, T.C. Memo. 2014-160, *appeal docketed*, No. 14-73680 (9th Cir. Dec. 2, 2014)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Jacobs v. Comm'r, T.C. Summ. Op. 2015-3	6662(b)(1), (2) - TP negligent in failing to report income; TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Jones v. Comm'r, T.C. Memo. 2014-125	6662(b)(1), (2) - TPs (H&W) acted with reasonable cause and in good faith	No	TP
Kaminski v. Comm'r, T.C. Summ. Op. 2015-7	6662(b)(2) - TP acted with reasonable cause and in good faith reliance on tax professional	Yes	TP
Kinuthia v. Comm'r, T.C. Memo. 2014-127	6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Le Beau v. Comm'r, T.C. Memo. 2014-198, *appeal docketed*, No. 15-70489 (9th Cir. Feb. 18, 2015)	6662(b)(1) - TP negligent in failing to maintain records	Yes	IRS
Lee v. Comm'r, T.C. Summ. Op. 2015-33	6662(b)(1), (2) - TP negligent in failing to maintain records; penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith	Yes	IRS
Lopez v. Comm'r, T.C. Summ. Op. 2015-22	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Luciano-Salas v. Comm'r, T.C. Summ. Op. 2014-76	6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith reliance on tax professional	Yes	IRS
Martarano v. Comm'r, T.C. Summ. Op. 2014-64	6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records; TPs substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Martarano v. Comm'r, T.C. Summ. Op. 2014-101	6662(b)(1) - Negligence penalty denied due to unfair surprise/prejudice	Yes	TP
McClellan v. Comm'r, T.C. Memo. 2014-257	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Metz v. Comm'r, T.C. Memo. 2015-54	6662(b)(1), (2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause	No	IRS

Case Citation	Issue(s)	*Pro Se*	Decision
Midwest Eye Ctr., S.C. v. Comm'r, T.C. Memo. 2015-53	6662(b)(2) - TP substantially understated income tax; failure to present evidence on reasonable cause and good faith	No	IRS
Minchem Int'l, Inc. v. Comm'r, T.C. Memo. 2015-56	6662(b)(1), (2) - No substantial understatement for investment interest and deductions of personal expenses; TPs (H&W) negligent in claiming home equity loan interest deduction and failing to report income; failure to establish reasonable cause and good faith reliance on tax professional	No	Split
Mylander v. Comm'r, T.C. Memo. 2014-191	6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records; penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith	No	IRS
Na v. Comm'r, T.C. Memo. 2015-21	6662(b)(1), (2) - TP negligent in failing to maintain records for some unreported income; penalty for substantial understatement of income tax applies provisionally to some unreported income; failure to present evidence of reasonable cause and good faith for some unreported income	No	Split
Nganga v. Comm'r, T.C. Summ. Op. 2014-50	6662(b)(2) - Penalty for substantial understatement of income tax applies provisionally; failure to argue reasonable cause or good faith	Yes	IRS
Nguyen v. Comm'r, T.C. Memo. 2014-199	6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to present evidence on reasonable cause and good faith reliance on tax preparer	No	IRS
Odujinrin v. Comm'r, T.C. Memo. 2014-213	6662(b)(1) - TP negligent in failing to maintain records; failure to present evidence on reasonable cause and good faith	Yes	IRS
Peterson v. Comm'r, T.C. Memo. 2015-1, *appeal docketed*, No. 15-73092 (9th Cir. Oct. 8, 2015)	6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith	Yes	IRS
Peterson v. Comm'r, T.C. Memo. 2015-23	6662(b)(1) - TP negligent in failing to maintain records; failure to present evidence on reasonable cause and good faith	Yes	IRS
Pospisil v. Comm'r, T.C. Summ. Op. 2014-100	6662(b)(1), (2) - TPs (H&W) not negligent; penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith	Yes	IRS
Powell v. Comm'r, T.C. Memo. 2014-235, *appeal docketed*, No. 15-1851 (4th Cir. July 30, 2015)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to argue reasonable cause and good faith	Yes	IRS
Price v. Comm'r, T.C. Memo. 2014-253, *appeal docketed*, No. 15-2196 (3d Cir. May 19, 2015)	6662(b)(2) - TPs (H&W) acted with reasonable cause and good faith	No	TP
Redisch v. Comm'r, T.C. Memo. 2015-95	6662(b)(2) - Penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith	No	IRS
Robinson v. Comm'r, T.C. Memo. 2014-120, *aff'd*, No. 15-1380 (4th Cir. Sept. 3, 2015)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Rogers v. Comm'r, T.C. Memo. 2014-141 *amended on reconsideration in part*, 2014 WL 6805465 (T.C. 2014)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Ross v. Comm'r, T.C. Summ. Op. 2014-68	6662(b)(1) - TP negligent in preparing the return; TP acted in good faith for reporting wages paid, but not for the remaining business deductions	Yes	Split
Safakish v. Comm'r, T.C. Memo. 2014-242, *appeal docketed*, No. 15-70826 (9th Cir. Mar. 17, 2015)	6662(b)(2) - TP substantially understated income tax; failure to argue reasonable cause and good faith	Yes	IRS

Case Citation	Issue(s)	*Pro Se*	Decision
Salem Fin., Inc. v. U.S., 786 F.3d 932 (Fed. Cir. 2015), *aff'g in part, reversing in part and remanding*, 112 Fed. Cl. 543 (2013), *petition for cert. filed*, No. 15-380 (Sept. 29, 2015)	6662(b)(1) - TP negligent in entering a transaction that lacked economic substance; failure to establish reasonable cause and good faith	No	IRS
Savello v. Comm'r, T.C. Memo. 2015-24	6662(b)(1) - TP negligent in failing to maintain records; failure to present evidence on reasonable cause and good faith	No	IRS
Savulionis v. Comm'r, T.C. Summ. Op. 2015-19	6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith	Yes	TP
Sawyer v. Comm'r, T.C. Memo. 2015-55	6662(b)(1) - TPs (H&W) negligent in failing to maintain records; Failure to present evidence on reasonable cause and good faith	No	IRS
Schumann v. Comm'r, T.C. Memo. 2014-138	6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith	No	IRS
Shah v. Comm'r, T.C. Memo. 2015-31, *appeal docketed*, No. 15-1773 (6th Cir. June 30, 2015)	6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records and erroneously claiming deductions; substantially understated income tax on one of two returns; failure to establish reasonable cause and good faith	Yes	IRS
Sheridan v. Comm'r, T.C. Memo. 2015-25	6662(b)(2) - TP substantially understated income tax; failure to present evidence on reasonable cause and good faith	Yes	IRS
Sievers v. Comm'r, T.C. Memo. 2014-115	6662(b)(1), (2) - TP negligent in failing to maintain records; penalty for substantial understatement of income tax applies provisionally; failure to present evidence on reasonable cause and good faith	Yes	IRS
Simpson v. Comm'r, T.C. Summ. Op. 2014-67	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Singhal v. Comm'r, T.C. Summ. Op. 2014-102	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Suder v. Comm'r, T.C. Memo. 2014-201	6662(b)(1), (2) - TPs (two shareholders) acted with reasonable cause and in good faith	No	TP
Tarighi v. Comm'r, T.C. Summ. Op. 2015-28	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to present evidence on reasonable cause and good faith	Yes	IRS
Villarreal v. Comm'r, T.C. Summ. Op. 2014-87	6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith	Yes	IRS
Wakefield v. Comm'r, T.C. Memo. 2015-4	6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records and distinguish personal from business expenses; penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith through reliance on promoter	No	IRS
Wells Fargo & Co. v. U.S., 114 A.F.T.R.2d (RIA) 5414 (D. Minn. 2014)	6662(b)(1) - TP not negligent, had reasonable basis for its reporting of the STARS transaction	No	TP
Williams v. Comm'r, T.C. Memo. 2014-158, *appeal docketed*, No. 15-71505 (9th Cir. May 19, 2015)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Wright v. Comm'r, T.C. Memo. 2014-175, *appeal docketed*, No. 15-1071 (6th Cir. Jan. 26, 2015)	6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional	Yes	IRS
Zierdt v. Comm'r, T.C. Summ. Op. 2014-78	6662(b)(2) - Penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith	Yes	IRS

TABLE 2 Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Bartley v. Comm'r, T.C. Summ. Op. 2015-23	Failure to meet § 274 substantiation requirements; personal expenses disallowed; work boot expense allowed under § 162	Yes	Split
Flores v. Comm'r, T.C. Memo. 2015-9	Failure to meet § 274 substantiation requirements; failure to substantiate expenses	Yes	IRS
Free-Pacheco v. U.S., 117 Fed. Cl. 228 (2014)	Not engaged in for profit under § 183; gambling expenses disallowed	No	IRS
Garza v. Comm'r, T.C. Memo. 2014-121	Failure to meet § 274 substantiation requirements	No	IRS
Howard v. Comm'r, T.C. Memo. 2015-38	Failure to substantiate expenses for travel; other expense allowed under § 162	Yes	Split
Jacobs v. Comm'r, T.C. Summ. Op. 2015-3	Failure to substantiate expenses	Yes	IRS
Jalloh v. Comm'r, T.C. Summ. Op. 2015-18	Failure to meet § 274 substantiation requirements; failure to substantiate expenses; Cohan rule applied to allow uniform and protective clothing expenses; union dues expense allowed under § 162	Yes	Split
Jermihov v. Comm'r, T.C. Summ. Op. 2014-75	Failure to meet § 274 substantiation requirements for vehicle and travel expenses; a portion of medical expenses allowed under § 162; Cohan rule applied to allow professional dues and subscriptions	Yes	Split
Lain v. Comm'r, T.C. Summ. Op. 2015-5	Deductions allowed for Schedule A expenses	Yes	TP
McCarty v. Comm'r, T.C. Summ. Op. 2014-81	Business expense allowed under § 162	Yes	TP
Meinhardt v. Comm'r, 766 F.3d 917 (8th Cir. 2014), *aff'g* T.C. Memo. 2013-85	Failure to establish overall activity as a qualifying trade or business within § 162(a); not engaged in for profit Under § 183	No	IRS
Miller v. Comm'r, T.C. Summ. Op. 2014-74	Failure to substantiate expenses for utilities and office supplies; failure to meet § 274 substantiation requirements; personal expenses disallowed for clothing; home office expense allowed under § 162; Cohan rule applied to allow telephone and Internet	No	Split
Monsalve v. Comm'r, T.C. Summ. Op. 2014-91	Failure to prove meals, entertainment, and gift expenses were ordinary and necessary; however, travel expense allowed under § 162	Yes	Split
Morataya v. Comm'r, T.C. Summ. Op. 2015-30	Failure to meet § 274 substantiation requirements; personal expenses disallowed; cell phone and tax return preparation fees allowed under § 162	Yes	Split
Ressen v. Comm'r, T.C. Summ. Op. 2015-32	Vehicle expenses allowed under § 162; however, failure to substantiate additional expenses	Yes	Split
Thomas-Kozak v. Comm'r, T.C. Summ. Op. 2014-104	Personal expenses disallowed; failure to meet § 274 substantiation requirements; some meals and unreimbursed employee expenses allowed under § 162	No	Split
Business Taxpayers (Corporate, Partnerships, Trusts, and Sole Proprietorships - Schedules C, E, F)			
ABC Beverage Corp. v. U.S., 756 F.3d 438 (6th Cir. 2014), *aff'g* 577 F. Supp. 2d 935 (W.D. Mich. 2008)	A portion of purchase price from lease buy out allowed under § 162	No	TP
Agugo v. Comm'r, T.C. Summ. Op. 2014-60	Failure to establish overall activity as a qualifying trade or business within § 162(a)	Yes	IRS

TABLE 2: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Akey v. Comm'r, T.C. Memo. 2014-211	Not engaged in for profit under § 183; failure to substantiate expenses	Yes	IRS
Alubunkudi v. Comm'r, T.C. Summ. Op. 2014-97	Failure to substantiate expenses	Yes	IRS
Annuzzi v. Comm'r, T.C. Memo. 2014-233	Horse racing activity was engaged in for profit under § 183	No	TP
Anyanwu v. Comm'r, T.C. Memo. 2014-123	Failure to substantiate expenses	Yes	IRS
Baker v. Comm'r, T.C. Memo. 2014-122	Failure to meet § 274 substantiation requirements; Cohan rule applied to allow some vehicle maintenance and license expenses	Yes	Split
Ball v. Comm'r, T.C. Summ. Op. 2014-83	Failure to meet § 274 substantiation requirements	Yes	IRS
Ballard-Bey v. Comm'r, T.C. Summ. Op. 2014-62	Failure to prove expense was ordinary and necessary	Yes	IRS
Bedrosian v. Comm'r, 144 T.C. No. 10 (2015)	Not engaged in for profit under § 183	No	IRS
Boring v. Comm'r, T.C. Summ. Op. 2014-105	Failure to meet § 274 substantiation requirements; failure to prove expense was ordinary and necessary; home office disallowed	Yes	IRS
Briley v. Comm'r, T.C. Memo. 2014-114, *appeal docketed*, No. 15-1461 (4th Cir. Apr. 29, 2015)	Failure to substantiate expenses	Yes	IRS
Bronson v. Comm'r, 591 F. App'x 625 (9th Cir. 2015), *aff'g* T.C. Memo. 2012-17	Not engaged in for profit under § 183	Yes	IRS
Bruce v. Comm'r, T.C. Memo. 2014-178, *aff'd*, *Bruce v. Comm'r*, 608 F. App'x 268 (5th Cir. 2015)	Personal expenses disallowed	No	IRS
Burke v. Comm'r, T.C. Summ. Op. 2015-24	Failure to substantiate expenses; failure to establish overall activity as a qualifying trade or business within § 162(a); home office disallowed; ferry expenses allowed under § 162	Yes	Split
Cherizol v. Comm'r, T.C. Memo. 2014-119	Failure to substantiate expenses; failure to meet § 274 substantiation requirements	Yes	IRS
Cooper v. Comm'r, 143 T.C. 194 (2014), *appeal docketed*, No. 15-70863 (9th Cir. Mar. 20, 2015)	Business expense allowed under § 162	No	TP
Crawford v. Comm'r, T.C. Memo. 2014-156	Failure to meet § 274 substantiation requirements	Yes	IRS
Crile v. Comm'r, T.C. Memo. 2014-202	Artwork activity was engaged in for profit under § 183	No	TP
Cullifer v. Comm'r, T.C. Memo. 2014-208, *appeal docketed*, No. 15-13539 (11th Cir. Aug. 7, 2015)	Failure to substantiate expenses for management and professional fees; however, other management fees allowed under § 162	No	Split
Del Castillo v. Comm'r, T.C. Summ. Op. 2015-35	Failure to establish overall activity as a qualifying trade or business within § 162(a); failure to meet § 274 substantiation requirements	Yes	IRS
Engstrom, Lipscomb & Lack, APC v. Comm'r, T.C. Memo. 2014-221, *appeal docketed*, No. 15-70591 (9th Cir. Feb. 26, 2015)	Failure to meet § 274 substantiation requirements for some travel expenses; however, other travel expenses allowed under § 162	No	Split
Evans v. Comm'r, T.C. Memo. 2014-237	Expenses were ordinary and necessary; Cohan rule applied to allow some expenses; motocross racing activity expenses were not personal expenses	No	TP
Fargo v. Comm'r, T.C. Memo. 2015-96	Failure to prove expense was ordinary and necessary	No	IRS
Gardner v. Comm'r, T.C. Memo. 2014-148	Not engaged in for profit under § 183	No	IRS

TABLE 2: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Graffia v. Comm'r, 580 F. App'x 474 (7th Cir. 2014), *aff'g* T.C. Memo. 2013-211	Failure to demonstrate transaction possessed economic substance	Yes	IRS
Guardian Indus. Corp. v. Comm'r, 143 T.C. 1 (2014)	Failure to prove expense was ordinary and necessary	No	IRS
Hall v. Comm'r, T.C. Memo. 2014-171	Failure to meet § 274 substantiation requirements; failure to substantiate expenses	Yes	IRS
Helms, U.S. v., 579 F. App'x 615 (9th Cir. 2014), *aff'g* 106 A.F.T.R.2d (RIA) 6008 (S.D. Cal. 2010)	Failure to meet § 274 substantiation requirements	No	IRS
Holden v. Comm'r, T.C. Memo. 2015-83	Failure to substantiate expenses	No	IRS
Hume v. Comm'r, T.C. Memo. 2014-135	Failure to establish overall activity as a qualifying trade or business within § 162(a); failure to substantiate expenses	Yes	IRS
Jackson v. Comm'r, T.C. Memo. 2014-160, *appeal docketed*, No. 14-73680 (9th Cir. Dec. 2, 2014)	Personal expenses disallowed	No	IRS
Jones v. Comm'r, T.C. Memo. 2014-125	Failure to substantiate expenses	No	IRS
Kaminski v. Comm'r, T.C. Summ. Op. 2015-7	Failure to meet § 274 substantiation requirements; failure to substantiate expenses for travel; personal expenses disallowed; Cohan rule applied to allow Internet expenses	Yes	Split
Kenna Trading, LLC v. Comm'r, 143 T.C. 322 (2014)	Failure to demonstrate transaction possessed economic substance	Yes	IRS
Kinuthia v. Comm'r, T.C. Memo. 2014-127	Failure to substantiate expenses	Yes	IRS
Koriakos v. Comm'r, T.C. Summ. Op. 2014-70	Personal expenses disallowed; failure to meet § 274 substantiation requirements; expenses allowed under § 162 for some advertising, repairs, maintenance, and other expenses	Yes	Split
Le Beau v. Comm'r, T.C. Memo. 2014-198, *appeal docketed*, No. 15-70489 (9th Cir. Feb. 18, 2015)	Failure to substantiate some expenses; other rental expenses and real estate tax allowed under § 162	Yes	Split
Lee v. Comm'r, T.C. Summ. Op. 2015-33	Failure to meet § 274 substantiation requirements; personal expenses disallowed	Yes	IRS
Legaspi v. Comm'r, T.C. Summ. Op. 2015-14	Failure to meet § 274 substantiation requirements	Yes	IRS
Longino v. Comm'r, 593 F. App'x 965 (11th Cir. 2014), *aff'g* T.C. Memo. 2013-80	Failure to meet § 274 substantiation requirements; home office disallowed; failure to substantiate expenses	Yes	IRS
Lussy v. Comm'r, T.C. Memo. 2015-35, *appeal docketed*, No. 15-11626 (11th Cir. Apr. 13, 2015)	Failure to substantiate expenses; personal expenses disallowed; failure to meet § 274 substantiation requirements	Yes	IRS
Martarano v. Comm'r, T.C. Summ. Op. 2014-101	Failure to prove expense was ordinary and necessary	Yes	IRS
Martarano v. Comm'r, T.C. Summ. Op. 2014-64	Failure to meet § 274 substantiation requirements; failure to prove expense was ordinary and necessary	Yes	IRS
McClellan v. Comm'r, T.C. Memo. 2014-257	Failure to meet § 274 substantiation requirements for entertainment, travel, and vehicle expenses; personal expenses disallowed; home office disallowed; other business expenses allowed under § 162; Cohan rule applied to allow postage and delivery costs	Yes	Split
Metz v. Comm'r, T.C. Memo. 2015-54	Horse breeding activity was engaged in for profit under § 183	No	TP
Midwest Eye Ctr., S.C. v. Comm'r, T.C. Memo. 2015-53	Failure to prove expense was ordinary and necessary	No	IRS
Miller v. Comm'r, T.C. Memo. 2014-105	Failure to substantiate expenses	Yes	IRS

Case Citation	Issue(s)	*Pro Se*	Decision
Moyer v. Comm'r, T.C. Memo. 2015-45	Failure to substantiate expenses; personal expenses disallowed; failure to meet § 274 substantiation requirements for vehicle expenses; some expenses allowed under § 162	No	Split
Musa v. Comm'r, T.C. Memo. 2015-58	Failure to substantiate expenses for additional wage deductions and some non-employee compensation; failure to meet § 274 substantiation requirements; Cohan rule applied to allow other non-employee compensation	No	Split
Mylander v. Comm'r, T.C. Memo. 2014-191	Cohan rule applied	No	TP
Nganga v. Comm'r, T.C. Summ. Op. 2014-50	Failure to substantiate expenses; business license expense allowed under § 162	Yes	Split
Nichols, U.S. v., 115 A.F.T.R.2d (RIA) 1971 (E.D. Wash. 2015)	Personal expenses disallowed	No	IRS
Odujinrin v. Comm'r, T.C. Memo. 2014-213	Failure to meet § 274 substantiation requirements for meal, entertainment, telephone, and vehicle expenses; failure to substantiate expenses for wages, rent, and insurance; however, other business expense allowed under § 162	Yes	Split
Peppers v. Comm'r, T.C. Summ. Op. 2014-55	Failure to meet § 274 substantiation requirements; personal expenses disallowed	Yes	IRS
Peterson v. Comm'r, T.C. Memo. 2015-23	Failure to meet § 274 substantiation requirements; personal expenses disallowed	Yes	IRS
Peterson v. Comm'r, T.C. Memo. 2015-1, *appeal docketed*, No. 15-73092 (9th Cir. Oct. 8, 2015)	Failure to meet § 274 substantiation requirements; home repair expense disallowed as a capital expenditure; airplane-related costs allowed under § 162	Yes	Split
Pospisil v. Comm'r, T.C. Summ. Op. 2014-100	Failure to meet § 274 substantiation requirements	Yes	IRS
Powell v. Comm'r, T.C. Memo. 2014-235, *appeal docketed*, No. 15-1851 (4th Cir. July 30, 2015)	Failure to establish overall activity as a qualifying trade or business within § 162(a); failure to meet § 274 substantiation requirements; failure to substantiate expenses	Yes	IRS
Price v. Comm'r, T.C. Memo. 2014-253, *appeal docketed*, No. 15-2196 (3d Cir. May 19, 2015)	Not engaged in for profit under § 183	No	IRS
Reddam v. Comm'r, 755 F.3d 1051 (9th Cir. 2014), *aff'g* T.C. Memo. 2012-106	Failure to demonstrate transaction possessed economic substance	No	IRS
Robinson v. Comm'r, T.C. Memo. 2014-120, *aff'd*, No. 15-1380 (4th Cir. Sept. 3, 2015)	Failure to establish overall activity as a qualifying trade or business within § 162(a); personal expenses disallowed; home office disallowed; failure to meet § 274 substantiation requirements	Yes	IRS
Rogers v. Comm'r, T.C. Memo. 2014-141 amended on reconsideration in part, 2014 WL 6805465 (T.C. 2014)	Failure to prove expense was ordinary and necessary; failure to meet § 274 substantiation requirements for some travel expenses, vehicle expenses, and meals; home office disallowed; however, other expenses allowed under § 162	No	Split
Ross v. Comm'r, T.C. Summ. Op. 2014-68	Home office disallowed; failure to prove expense was ordinary and necessary	Yes	IRS
Safakish v. Comm'r, T.C. Memo. 2014-242, *appeal docketed*, No. 15-70826 (9th Cir. Mar. 17, 2015)	Failure to substantiate legal and professional expenses; failure to meet § 274 substantiation requirements for travel and vehicle expenses; rent expense allowed under § 162	Yes	Split
Savello v. Comm'r, T.C. Memo. 2015-24	Personal expenses disallowed; model airplane retail store activity was engaged in for profit under § 183	No	Split
Savulionis v. Comm'r, T.C. Summ. Op. 2015-19	Home office disallowed; personal expenses disallowed	Yes	IRS
Sawyer v. Comm'r, T.C. Memo. 2015-55	Cohan rule applied	No	TP
Schumann v. Comm'r, T.C. Memo. 2014-138	Home office disallowed	No	IRS

Case Citation	Issue(s)	*Pro Se*	Decision
Securitas Holdings, Inc. v. Comm'r, T.C. Memo. 2014-225	Business expenses allowed under § 162	No	TP
Shah v. Comm'r, T.C. Memo. 2015-31, *appeal docketed*, No. 15-1773 (6th Cir. June 30, 2015)	Failure to substantiate expenses; failure to meet § 274 substantiation requirements; personal expenses disallowed; not engaged in for profit under § 183	Yes	IRS
Sheridan v. Comm'r, T.C. Memo. 2015-25	Failure to substantiate expenses for § 165 loss deduction	Yes	IRS
Sievers v. Comm'r, T.C. Memo. 2014-115	Home office disallowed; personal expenses disallowed for home renovation expenses and tuition; business vehicle repairs and fuel expense allowed under § 162	Yes	Split
Simpson v. Comm'r, T.C. Summ. Op. 2014-67	Not engaged in for profit under § 183	No	IRS
Sodipo v. Comm'r, T.C. Memo. 2015-3, *appeal docketed*, No. 15-2089 (4th Cir. Sept. 16, 2015)	Failure to substantiate expenses	Yes	IRS
Stuller, Estate of v. U.S., 55 F. Supp. 3d 1091 (C.D. Ill. 2014), *appeal docketed*, No. 15-1545 (7th Cir. Mar. 13, 2015)	Not engaged in for profit under § 183	No	IRS
Tarighi v. Comm'r, T.C. Summ. Op. 2015-28	Failure to establish overall activity as a qualifying trade or business within § 162(a); failure to meet § 274 substantiation requirements for mileage; failure to substantiate other expenses; however, real estate tax expense allowed under § 162	Yes	Split
Vanney Assocs., Inc. v. Comm'r, T.C. Memo. 2014-184	Failure to demonstrate transaction possessed economic substance	No	IRS
Villarreal v. Comm'r, T.C. Summ. Op. 2014-87	Personal expenses disallowed for credit card interest; however, other business expenses allowed under § 162	Yes	Split
Villegas v. Comm'r, T.C. Memo. 2015-33	Failure to substantiate expenses	Yes	IRS
Wakefield v. Comm'r, T.C. Memo. 2015-4	Failure to meet § 274 substantiation requirements for vehicle expenses; failure to prove professional and legal expenses were ordinary and necessary; failure to substantiate seminar expenses, some marketing expenses, some office expenses, and contract labor expenses; personal expenses disallowed; Cohan rule applied to allow tax preparation fees; other business expenses allowed under § 162	No	Split
Watson v. Comm'r, T.C. Summ. Op. 2014-108	Failure to substantiate some rental and contract labor expenses; other business expenses allowed under § 162	No	Split
Zierdt v. Comm'r, T.C. Summ. Op. 2014-78	Failure to substantiate expenses for newspapers; gambling expenses disallowed; some cell phone expenses allowed under § 162	Yes	Split

TABLE 3 Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Abusch v. U.S., 114 A.F.T.R.2d (RIA) 5535 (M.D. La. 2014), *adopting* 114 A.F.T.R.2d (RIA) 5533 (M.D. La. 2014), *cert. denied*, No. 14-948 (Mar. 23, 2015)	TPs' petition to quash denied; Lack of subject matter jurisdiction	Yes	IRS
Advanced Health Strategies, Inc. v. U.S., 115 A.F.T.R.2d (RIA) 411 (D. Minn. 2015), *adopting* 115 A.F.T.R.2d (RIA) 410 (D. Minn. 2014)	TPs' petition to quash third-party summons denied	Yes	IRS
Ali, U.S. v., 114 A.F.T.R.2d (RIA) 6524 (D. Md. 2014)	Summons partially enforced and partially denied; TP denied Fifth Amendment privilege for certain documents; TP entitled to Fifth Amendment privilege for testimony and other records and to attorney-client privilege for a specific document	No	Split
Anderson, U.S. v., 114 A.F.T.R.2d (RIA) 6731 (N.D. Cal. 2014), *stay denied*, 115 A.F.T.R.2d	Summons enforced; TP did not show summons was issued in bad faith	No	IRS
Anderson, U.S. v., 115 A.F.T.R.2d (RIA) 468 (N.D. Cal. 2015), *enforcing* 114 A.F.T.R.2d (RIA) 6731 (N.D. Cal. 2014), *appeal docketed*, No. 15-15130 (9th Cir. Jan. 26, 2015)	TP's motion to stay enforcement denied	No	IRS
Becher, U.S. v., 115 A.F.T.R.2d (RIA) 1113 (S.D. Fla. 2015)	Summons enforced	Yes	IRS
Belcik, U.S. v., 115 A.F.T.R.2d (RIA) 1782 (M.D. Fla. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1779 (M.D. Fla. 2015)	Summons enforced	Yes	IRS
Berthiaume, U.S. v., 2015 U.S. Dist. LEXIS 24715 (D. Minn. 2015), *adopting* 115 A.F.T.R.2d (RIA) 999 (D. Minn. 2015)	Summons enforced	Yes	IRS
Billie, U.S. v., 114 A.F.T.R.2d (RIA) 5694 (S.D. Fla. 2014), *aff'd*, 2015 U.S. App. LEXIS 9046 (11th Cir. 2015)	Summons enforced	No	IRS
Blackrock Fin. Partners, LLC v. U.S., 114 A.F.T.R.2d (RIA) 6941 (E.D. Mich. 2014)	TP's petition to quash denied; Lack of subject matter jurisdiction	No	IRS
Bohn, U.S. v., 115 A.F.T.R.2d (RIA) 381 (E.D. Cal. 2015), *adopting* 114 A.F.T.R.2d (RIA) 6541 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Brayshaw, U.S. v., 114 A.F.T.R.2d (RIA) 6000 (E.D. Cal. 2014), *adopting* 114 A.F.T.R.2d (RIA) 5770 (E.D. Cal. 2014)	Summons enforced	No	IRS
Brown, U.S. v., 114 A.F.T.R.2d (RIA) 6879 (D.N.J. 2014)	Summons enforced	Yes	IRS
Chaffee, U.S. v., 115 A.F.T.R.2d (RIA) 1029 (E.D. Mich. 2015)	TP's motion to quash summons denied	Yes	IRS
Erickson, U.S. v., 115 A.F.T.R.2d (RIA) 684 (M.D. Fla. 2015)	TP held in contempt	Yes	IRS
Franks, U.S. v., 115 A.F.T.R.2d (RIA) 312 (E.D. Cal. 2014), *adopting* 114 A.F.T.R.2d (RIA) 6502 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Furgison-Mayall, U.S. v., 115 A.F.T.R.2d (RIA) 1217 (E.D. Cal. 2015), *adopting* 115 A.F.T.R.2d (RIA) 997 (E.D. Cal. 2015)	Summons enforced	Yes	IRS

TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Gamboa, U.S. v., 114 A.F.T.R.2d (RIA) 5357 (E.D. Cal. 2014), *adopting* 113 A.F.T.R.2d (RIA) 2194 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Gandrup v. U.S., 114 A.F.T.R.2d (RIA) 6576 (D. Del. 2014)	TP's motion to quash third-party summons denied	Yes	IRS
Garcia v. U.S., 113 A.F.T.R.2d (RIA) 2462 (S.D. Tex. 2014), *adopting* 113 A.F.T.R.2d (RIA) 2459 (S.D. Tex. 2014)	TP's motion to dismiss third-party summons dismissed; Lack of subject matter jurisdiction	No	IRS
Hayes, U.S. v., 2015 U.S. Dist. LEXIS 43333 (M.D.N.C. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1001 (M.D.N.C. 2015)	Summons enforced	No	IRS
Hearn, U.S. v., 2014 U.S. Dist. LEXIS 103390 (M.D. Fla. 2014), *adopting* 2014 U.S. Dist. LEXIS 103388 (M.D. Fla. 2014)	Summons enforced	Yes	IRS
Hunkler v. U.S., 115 A.F.T.R.2d (RIA) 1340 (S.D. Ohio 2015), *adopting* 113 A.F.T.R.2d (RIA) 1788 (S.D. Ohio 2014)	TP's motion to quash third-party summons denied	Yes	IRS
Hunkler v. U.S., 114 A.F.T.R.2d (RIA) 5604 (N.D. Ohio 2014), *adopting* 114 A.F.T.R.2d (RIA) 5601 (N.D. Ohio 2014)	TP's motion to quash third-party summons denied; Lack of subject matter jurisdiction	Yes	IRS
Igelshteyn, U.S. v., 115 A.F.T.R.2d (RIA) 911 (D.N.J. 2014)	Summons enforced	Yes	IRS
Kim, U.S. v., 2015 U.S. Dist. LEXIS 44902 (C.D. Cal. 2015), *enforced*, No. 2:15-cv-01778 (C.D. Cal. May 4, 2015)	Summons enforced	Yes	IRS
Kitson, U.S. v., 115 A.F.T.R.2d (RIA) 755 (N.D. Cal. 2015), *adopting* 115 A.F.T.R.2d (RIA) 753 (N.D. Cal. 2014)	Summons enforced	Yes	IRS
Klingenberg, U.S. v., 114 A.F.T.R.2d (RIA) 6546 (E.D. Cal. 2014), *adopting* 114 A.F.T.R.2d (RIA) 6374 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Knudsen v. U.S., 114 A.F.T.R.2d (RIA) 5777 (D. Del. 2014)	TP's motion to quash third-party summons dismissed; Lack of subject matter jurisdiction	Yes	IRS
Knudsen v. U.S., 114 A.F.T.R.2d (RIA) 5848 (E.D.N.Y. 2014)	TP's motion to quash third-party summons dismissed; Lack of subject matter jurisdiction	Yes	IRS
Le v. U.S. IRS, 2015 U.S. Dist. LEXIS 3836 (S.D. Tex. 2015)	TP's motion to quash third-party summons dismissed; Lack of subject matter jurisdiction	Yes	IRS
Le v. U.S., 2014 U.S. Dist. Lexis 90696 (N.D. Tex. 2014), *adopting* 2014 U.S. Dist. Lexis 91305 (N.D. Tex. 2014)	TP's motion to quash third-party summons dismissed; Lack of subject matter jurisdiction	Yes	IRS
Leitao, U.S. v., 114 A.F.T.R.2d (RIA) 5017 (N.D. Cal. 2014)	Summons enforced	Yes	IRS
Little, U.S. v., 115 A.F.T.R.2d (RIA) 989 (E.D. Cal. 2015), *adopting* 114 A.F.T.R.2d (RIA) 7049 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Martin v. U.S., 2015 WL 3606069 (S.D. Cal. 2015)	Summons enforced; TP's petition to quash denied	Yes	IRS
McCarthy, U.S. v., 115 A.F.T.R.2d (RIA) 770 (S.D. Cal. 2015)	Summons enforced	Yes	IRS
McEligot, U.S. v., 115 A.F.T.R.2d (RIA) 1433 (N.D. Cal. 2015), *appeals docketed*, No. 15-16128 (9th Cir. June 4, 2015) & No. 15-16134 (9th Cir. June 5, 2015)	Summons enforced; Motion to dismiss denied; TP does not have an absolute right to be present at a third-party summons hearing; TP's right to intervene dependent on a balancing test	No	IRS

TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Mockler, U.S. v., 2014 U.S. Dist. LEXIS 74911 (E.D. Tex. 2014), *adopting* 2014 U.S. Dist. LEXIS 75419 (E.D. Tex. 2014)	Summons enforced	Yes	IRS
Nakamura, U.S. v., 115 A.F.T.R.2d (RIA) 760 (D. Haw. 2014)	Summons enforced	No	IRS
Nelson, U.S. v., 115 A.F.T.R.2d (RIA) 636 (E.D. Cal. 2015), *adopting* 114 A.F.T.R.2d (RIA) 6988 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Nichols, U.S. v., 2015 U.S. Dist. LEXIS 59444 (E.D. Mich. 2015), *enforcing*, No. 2:14-mc-50455 (E.D. Mich. Oct. 30, 2014)	TP held in contempt	Yes	IRS
Ochoa, U.S. v., 114 A.F.T.R.2d (RIA) 6619 (E.D. Cal. 2014), *adopting* 114 A.F.T.R.2d (RIA) 6499 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Palma v. U.S., 114 A.F.T.R.2d (RIA) 5568 (S.D. Tex. 2014)	TP's petition to quash third-party summons dismissed; Lack of subject matter jurisdiction	Yes	IRS
Ramirez v. U.S., 604 F. App'x 575 (9th Cir. 2015), *aff'g* 114 A.F.T.R.2d (RIA) 6098 (C.D. Cal. 2014)	Dismissal of TP's petition to quash third-party summons for lack of subject matter jurisdiction affirmed	Yes	IRS
Ramirez v. U.S., 114 A.F.T.R.2d (RIA) 6098 (C.D. Cal. 2014), *aff'd*, 604 F. App'x 575 (9th Cir. 2015)	TP's petition to quash third-party summons dismissed; Lack of subject matter jurisdiction	Yes	IRS
Ramirez v. U.S., 604 F. App'x 556 (9th Cir. 2015)	Denial of TP's petition to quash third-party summons affirmed	Yes	IRS
Raymond, U.S. v., 115 A.F.T.R.2d (RIA) 696 (W.D. Wis. 2015)	Summons enforced	Yes	IRS
Remsik, U.S. v., 2014 U.S. Dist. LEXIS 161708 (E.D. Tex. 2014), *adopting* 2014 U.S. Dist. LEXIS 162020 (E.D. Tex. 2014)	Summons enforced	Yes	IRS
Rodriguez, U.S. v., 113 A.F.T.R.2d (RIA) 2613 (E.D. Cal. 2014), *adopting* 113 A.F.T.R.2d (RIA) 2318 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Rowe, U.S. v., 2015 U.S. Dist. LEXIS 70660 (N.D. Cal. 2015)	Summons enforced	Yes	IRS
Sanders, U.S. v., 115 A.F.T.R.2d (RIA) 438 (E.D. Cal. 2015), *adopting* 114 A.F.T.R.2d (RIA) 6648 (E.D. Cal. 2014)	Summons enforced	Yes	IRS
Schultz, U.S. v., 2014 U.S. Dist. LEXIS 174918 (D. Minn. 2014), *adopting* 2014 U.S. Dist. LEXIS 174231 (D. Minn. 2014)	Summons enforced	Yes	IRS
Schwartz v. U.S., 115 A.F.T.R.2d (RIA) 1942 (S.D. Fla. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1939 (S.D. Fla. 2015)	TP's motion to quash denied; TP did not show summons was issued in bad faith; No attorney-client privilege; TP not entitled to an evidentiary hearing	No	IRS
Snow, U.S. v., 114 A.F.T.R.2d (RIA) 6965 (E.D. Tenn. 2014)	Summons enforced	Yes	IRS
Snow, U.S. v., 115 A.F.T.R.2d (RIA) 1002 (E.D. Tenn. 2015)	TP held in contempt	Yes	IRS
Sopher, U.S. v., 114 A.F.T.R.2d (RIA) 6423 (W.D. Wis. 2014)	Summons enforced	Yes	IRS
Taylor, U.S. v., 115 A.F.T.R.2d (RIA) 1165 (C.D. Cal. 2015)	Summons denied; Powell requirements not satisfied; Documents requested not relevant to the investigation	Yes	TP

Case Citation	Issue(s)	*Pro Se*	Decision
Terrell, U.S. v., 114 A.F.T.R.2d (RIA) 6898 (N.D. Ga. 2014), *adopting* 114 A.F.T.R.2d (RIA) 6880 (N.D. Ga. 2014)	Summons enforced	Yes	IRS
Thornton, U.S. v., 114 A.F.T.R.2d (RIA) 5598 (D. Minn. 2014), *adopting* 114 A.F.T.R.2d (RIA) 5594 (D. Minn. 2014)	Summons enforced	Yes	IRS
Thornton, U.S. v., 115 A.F.T.R.2d (RIA) 1258 (D. Minn. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1255 (D. Minn. 2015), *appeal docketed*, No. 15-1774 (8th Cir. Apr. 15, 2015)	TP held in contempt	Yes	IRS
Van Der Leest, U.S. v., 115 A.F.T.R.2d (RIA) 1684 (S.D. Ill. 2014), *adopting* 115 A.F.T.R.2d (RIA) 1682 (S.D. Ill. 2014)	Summons enforced	Yes	IRS
Vanderpool, U.S. v., 114 A.F.T.R.2d (RIA) 6968 (W.D. Mo. 2014), *adopting* 114 A.F.T.R.2d (RIA) 6966 (W.D. Mo. 2014)	TP held in contempt	Yes	IRS
Williams, U.S. v., 114 A.F.T.R.2d (RIA) 6023 (W.D. Wis. 2014)	Summons enforced	Yes	IRS
Zajac v. U.S., 113 A.F.T.R.2d (RIA) 2574 (M.D. Fla. 2014)	Summons enforced; TP's motion to quash denied	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedule C, E, F)			
Alpha Tech USA, LLC v. U.S., 115 A.F.T.R.2d (RIA) 384 (E.D. Tex. 2015)	TP's petition to quash dismissed; Lack of subject matter jurisdiction	No	IRS
Artex Risk Solutions, Inc., U.S. v., 2014 U.S. Dist. LEXIS 126932 (N.D. Ill. 2014)	Summons enforced; Motion for rule to show cause granted; TP did not show summons was issued in bad faith	No	IRS
Bowler, U.S. v., 2014 U.S. Dist. LEXIS 160132 (D. Minn. 2014), *adopting* 2014 U.S. Dist. LEXIS 160884 (D. Minn. 2014)	Summons enforced	Yes	IRS
Bowler, U.S. v., 2015 U.S. Dist. LEXIS 57862 (D. Minn. 2015), *adopting* 2015 U.S. Dist. LEXIS 58735 (D. Minn. 2015)	TP held in contempt	Yes	IRS
Chabot, U.S. v., 114 A.F.T.R.2d (RIA) 6235 (D.N.J. 2014), *aff'd*, No. 14-4465 (3d Cir. July 17, 2015)	Summons enforced; TP's Fifth Amendment claim denied; Required Records Doctrine applies to foreign bank account information requested under the Bank Secrecy Act	No	IRS
Clarke, U.S. v., 115 A.F.T.R.2d (RIA) 836 (S.D. Fla. 2015), *appeal docketed*, No. 15-11663 (11th Cir. Apr. 17, 2015)	Summons enforced; TP did not show a plausible inference of improper motive	No	IRS
Clarke, U.S. v., 134 S. Ct. 2361 (2014), *vacating* 517 F. App'x 689 (11th Cir. 2013), *vacating* 2012 U.S. Dist. LEXIS 188084 (S.D. Fla. 2012)	TP must allege specific facts that raise an inference of bad faith to examine an IRS official	No	IRS
Ghafourifar, U.S. v., 114 A.F.T.R.2d (RIA) 6649 (N.D. Cal. 2014)	Summons enforced	No	IRS
Ghislain, U.S. v., 115 A.F.T.R.2d (RIA) 694 (D. Vt. 2015)	Summons enforced	Yes	IRS
Haw. Pac. Fin., Ltd. v. U.S., 114 A.F.T.R.2d (RIA) 5640 (D. Haw. 2014), *adopting* 114 A.F.T.R.2d (RIA) 5637 (D. Haw. 2014)	Summons enforced; TP's petition to quash denied; TP did not show summons was issued in bad faith	No	IRS
Hernandez Tax Inc. v. U.S., 114 A.F.T.R.2d (RIA) 5123 (D.N.M. 2014)	Summons enforced; TP lacked standing to challenge under Right to Privacy Act	Yes	IRS
Highland Capital Mgmt., L.P. v. U.S., 51 F. Supp. 3d 544 (S.D.N.Y. 2014), *aff'd in part and vacated in part*, *2015 U.S. App. LEXIS 17112 (2d Cir. 2015)*	Summons enforced; TP's motion to quash third-party summons denied; TP did not show summons was issued for an improper purpose	No	IRS

Case Citation	Issue(s)	*Pro Se*	Decision
Masciantonio v. U.S., 114 A.F.T.R.2d (RIA) 7010 (W.D. Pa. 2014), *appeal docketed*, No. 15-1072 (3d Cir. Jan. 9, 2015)	Summons enforced; TP's motion to quash third-party summons denied; TP not entitled to an evidentiary hearing	Yes	IRS
Petry, U.S. v., 114 A.F.T.R.2d (RIA) 6770 (D. Minn. 2014), *adopting* 114 A.F.T.R.2d (RIA) 6769 (D. Minn. 2014)	Summons enforced	Yes	IRS
Ramirez v. U.S., 604 F. App'x 567 (9th Cir. 2015)	Denial of TP's petition to quash third-party summons affirmed	Yes	IRS
Sanmina Corp. & Subsidiaries, U.S. v., 2015 U.S. Dist. LEXIS 66123 (N.D. Cal. 2015), *appeal docketed*, No. 15-16416 (9th Cir. July 15, 2015)	Summons denied; Documents protected by attorney-client and work product privileges	No	TP
Titan Int'l Inc., U.S. v., 114 A.F.T.R.2d (RIA) 6934 (C.D. Ill. 2014), *appeal docketed*, No. 14-3789 (7th Cir. Dec. 29, 2014)	Summons enforced; TP's motion to quash denied	No	IRS
Von Biberstein, U.S. v., 115 A.F.T.R.2d (RIA) 1175 (E.D.N.C. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1171 (E.D.N.C. 2015)	Summons enforced; no attorney-client privilege	No	IRS
Von Biberstein, U.S. v., 115 A.F.T.R.2d (RIA) 1177 (E.D.N.C. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1173 (E.D.N.C. 2015)	TP's motion to quash third-party summons dismissed; Lack of subject matter jurisdiction	Yes	IRS
Xoriant Corp. v. U.S., 114 A.F.T.R.2d (RIA) 6461 (N.D. Cal. 2014)	TP's motion to quash denied; Lack of subject matter jurisdiction	No	IRS

TABLE 4 Gross Income Under IRC § 61 and Related Sections

Case Citation	Issues	*Pro Se*	Decision
Individual Taxpayers (But not Sole Proprietorships)			
Abrahamsen v. Comm'r, 142 T.C. 405 (2014)	Unreported wage income	No	IRS
Ambrosius v. Comm'r, T.C. Memo. 2014-126	Unreported military allowance income	Yes	IRS
Bacon v. Comm'r, T.C. Summ. Op. 2015-15	Unreported cancellation of debt income	Yes	TP
Blangiardo v. Comm'r, T.C. Memo. 2014-110	Unreported capital gain from sale of real property	Yes	IRS
Bohner v. Comm'r, 143 T.C. 224 (2014)	Unreported IRA withdrawal	No	IRS
Bowers v. Comm'r, T.C. Memo. 2014-130	Unreported Social Security income and pension distribution	Yes	IRS
Campbell v. Comm'r, T.C. Summ. Op. 2014-109	Unreported disability retirement income	No	IRS
Carlson v. Comm'r, 604 F. App'x 628 (9th Cir. 2015)	Unreported income	Yes	IRS
Carrancho v. Comm'r, T.C. Summ. Op. 2015-29	Unreported Social Security income	Yes	IRS
Cortes v. Comm'r, T.C. Memo. 2014-181, *appeal docketed*, No. 15-71129 (9th Cir. Apr. 13, 2015)	Unreported income	No	IRS
Dabney v. Comm'r, T.C. Memo. 2014-108	Unreported IRA withdrawal	Yes	IRS
Duffy v. U.S., 120 Fed. Cl. 55 (Fed. Cl. 2015), *appeal docketed*, No. 15-5076 (Fed. Cir. Apr. 28, 2015)	Settlement proceeds under IRC § 104(a)(2)	Yes	IRS
Ebert v. Comm'r, T.C. Memo. 2015-5	Unreported dividend income	Yes	TP
El v. Comm'r, 144 T.C. No. 9 (2015)	Unreported wage income and retirement account distribution	Yes	IRS
English v. Comm'r, T.C. Summ. Op. 2014-66	Unreported Social Security disability income	Yes	IRS
Evans v. Comm'r, T.C. Memo. 2015-12	Unreported foreign earned income	No	IRS
Fennel v. Comm'r, 579 F. App'x 767 (11th Cir. 2014)	Unreported income	Yes	IRS
Fisher v. Comm'r, T.C. Memo. 2014-219	Unreported compensation for services	Yes	IRS
Halo v. Comm'r, T.C. Summ. Op. 2014-92	Unreported Social Security income	Yes	IRS
Heckman v. Comm'r, T.C. Memo. 2014-131, *aff'd*, No. 14-3251 (8th Cir. June 10, 2015)	Unreported distribution from employee stock plan	No	IRS
Hughes v. Comm'r, T.C. Memo. 2015-89	Unreported long-term capital gains	No	IRS
Johnston v. Comm'r, T.C. Memo. 2015-91	Unreported cancellation of debt income	No	TP
Ktsanes v. Comm'r, T.C. Summ. Op. 2014-85	Settlement proceeds under IRC § 104(a)(1),(2), or (3)	Yes	IRS
Licha v. Comm'r, 586 F. App'x 350 (9th Cir. 2014), *aff'g* T.C. Memo. 2011-275	Unreported capital gains and other income	Yes	IRS
Lobs v. Comm'r, T.C. Summ. Op. 2015-17	Unreported interest income	Yes	IRS
Marran v. Comm'r, T.C. Summ. Op. 2015-21	Unreported lump sum payment	Yes	IRS
McCarthy v. Comm'r, T.C. Memo. 2015-50	Unreported retirement income and Social Security income	Yes	IRS
McKnight v. Comm'r, T.C. Memo. 2015-47	Unreported retirement plan distribution	Yes	IRS
Morles v. Comm'r, T.C. Summ. Op. 2015-13	Unreported retirement plan and IRA distributions	Yes	Split
Morris v. Comm'r, T.C. Memo. 2015-82	Unreported distribution from IRA	Yes	IRS
Mylander v. Comm'r, T.C. Memo. 2014-191	Unreported cancellation of debt income	No	IRS
Nix v. Comm'r, 580 F. App'x 887 (11th Cir. 2014)	Unreported wage and dividend income	Yes	IRS
Perez v. Comm'r, 144 T.C. 51 (2015)	Damages under IRC § 104(a)(2)	No	IRS

TABLE 4: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issues	*Pro Se*	Decision
Roa v. Comm'r, 583 F. App'x 125 (4th Cir. 2014)	Unreported wage income	Yes	IRS
Robertson v. Comm'r, T.C. Memo. 2014-143	Unreported wage income and distribution from 401(k)	Yes	IRS
Rogers v. Comm'r, 783 F.3d 320 (D.C. Cir. 2015), *aff'g and remanding in part* T.C. Memo. 2013-77, *petition for cert. filed*, No. 15-286 (Sept. 8, 2015)	Unreported foreign earned income	Yes	IRS
Sabolic v. Comm'r, T.C. Memo. 2015-32	Unreported tip income	Yes	TP
Salmonson v. Comm'r, T.C. Memo. 2014-244	Unreported income	Yes	IRS
Sewards v. Comm'r, 785 F.3d 1331 (9th Cir. 2015), *aff'g* 138 T.C. 320 (2012)	Unreported pension income	No	IRS
Shankar v. Comm'r, 143 T.C. 140 (2014)	Unreported income from redemption of "thank you points"	Yes	IRS
Shi v. Comm'r, T.C. Memo. 2014-173	Unreported interest income	Yes	IRS
Smith v. Comm'r, T.C. Summ. Op. 2014-93	Settlement proceeds under IRC § 104(a)(2)	Yes	IRS
Speer v. Comm'r, 144 T.C. No. 14 (2015)	Unreported lump sum payout for accrued vacation and sick leave	Yes	IRS
Topsnik v. Comm'r, 143 T.C. 240 (2014), *appeal docketed*, No. 15-1251 (D.C. Cir. July 29, 2015)	Unreported capital gains income	No	IRS
Waltner v. Comm'r, T.C. Memo. 2014-133	Unreported wage income and mutual shares sale	No	Split
Wyatt v. Comm'r, T.C. Summ. Op. 2015-31	Unreported cancellation of debt income	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)			
Anyanwu v. Comm'r, T.C. Memo. 2014-123	Unreported state income tax refund, proceeds from sale of real properties, and other income	Yes	Split
Balice v. Comm'r, T.C. Memo. 2015-46, *appeal docketed*, No. 15-2366 (3d Cir. June 5, 2015)	Unreported business income	Yes	IRS
Brown v. Comm'r, T.C. Memo. 2014-167, *appeal docketed*, No. 15-3033 (2d Cir. Sept. 28, 2015)	Unreported business income	No	IRS
Bruce v. Comm'r, T.C. Memo. 2014-178, *aff'd*, No. 14-60910 (5th Cir. June 25, 2015)	Unreported capital gain income from sale of business stock	No	IRS
Burke v. Comm'r, T.C. Summ. Op. 2015-24	Unreported business income	Yes	IRS
Chai v. Comm'r, T.C. Memo. 2015-42, *appeal docketed*, No. 15-1653 (2d Cir. May 19, 2015)	Unreported non-employee compensation	No	IRS
Coastal Heart Med. Grp., Inc. v. Comm'r, T.C. Memo. 2015-84	Unreported constructive dividend income	No	IRS
Cosentino v. Comm'r, T.C. Memo. 2014-186	Unreported settlement proceeds	No	Split
Duong v. Comm'r, T.C. Memo. 2015-90	Unreported business and tip income	Yes	Split
Elbaz v. Comm'r, T.C. Memo. 2015-49	Unreported state income tax refund	No	IRS
Gunnick, U.S. v., 115 A.F.T.R.2d (RIA) 1073 (D. Minn. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1062 (D. Minn. 2015)	Unreported wage, farm, and interest income, patronage dividends, and non-employee compensation	Yes	IRS
Hillman v. Comm'r, T.C. Memo. 2014-250	Unreported business income	Yes	TP
Jones v. Comm'r, T.C. Memo. 2014-125	Unreported business and self-employment income	No	Split
Kernan v. Comm'r, T.C. Memo. 2014-228, *appeal docketed*, No. 15-70574 (9th Cir. Feb. 25, 2015)	Unreported business income	Yes	IRS
Kinuthia v. Comm'r, T.C. Memo. 2014-127	Unreported business income	Yes	IRS
Koriakos v. Comm'r, T.C. Summ. Op. 2014-70	Unreported cancellation of debt income	Yes	IRS
Maines v. Comm'r, 144 T.C. No. 8 (2015)	Unreported refundable state tax credits	No	Split

TABLE 4: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issues	*Pro Se*	Decision
Miller v. Comm'r, T.C. Memo. 2014-105	Unreported non-employee compensation	Yes	IRS
Minchem Int'l, Inc. v. Comm'r, T.C. Memo. 2015-56	Unreported income from foreign investment transfers	No	Split
Moses v Comm'r, T.C. Memo. 2014-220	Unreported business income	Yes	IRS
Mottahedeh v. Comm'r, T.C. Memo. 2014-258	Unreported business income	Yes	IRS
Na v. Comm'r, T.C. Memo. 2015-21	Unreported non-employee compensation	No	Split
Powell v. Comm'r, T.C. Memo. 2014-235, *appeal docketed*, No. 15-1851 (4th Cir. July 30, 2015)	Unreported health insurance benefits, capital gain from sale of property, and Social Security income	Yes	IRS
Rader v. Comm'r, 143 T.C. 376 (2014)	Unreported business income	Yes	IRS
Rogers v. Comm'r, T.C. Memo. 2014-141	Unreported business income	No	Split
Roudakov v. Comm'r, T.C. Memo. 2014-193	Unreported business income	Yes	IRS
Sawyer v. Comm'r, T.C. Memo. 2015-55	Unreported business income	No	Split
Shasta Strategic Inv. Fund LLC v. U.S., 114 A.F.T.R.2d (RIA) 6990 (N.D. Cal. 2014)	Unreported interest income	No	TP
Sodipo v. Comm'r, T.C. Memo. 2015-3, *appeal docketed*, No. 15-2089 (4th Cir. Sept. 16, 2015)	Unreported business income	Yes	IRS
SWF Real Estate LLC v. Comm'r, T.C. Memo. 2015-63	Unreported income from the sale of state tax credits	No	IRS
Villegas v. Comm'r, T.C. Memo. 2015-33	Unreported proceeds from sale of non-principal residence	Yes	IRS
Wheeler v. Comm'r, T.C. Memo. 2014-204	Unreported business and rental income	Yes	IRS
Worth v. Comm'r, T.C. Memo. 2014-232, *appeal docketed*, No. 15-70665 (9th Cir. Mar. 3, 2015)	Unreported business income	Yes	IRS
Young v. Comm'r, T.C. Memo. 2015-18	Unreported business income	Yes	IRS

TABLE 5 Appeals From Collection Due Process Hearings Under IRS §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)				
Anderson v. Comm'r, T.C. Memo. 2014-216	Lien/Levy	No abuse of discretion in denying face-to-face hearing since TPs (H&W) did not provide information requested	Yes	IRS
Babak Roshdieh, M.D. Corp. v. Comm'r, T.C. Summ. Op. 2014-113	Levy	Collection action was properly sustained	No	IRS
Bateman v. Comm'r, T.C. Memo. 2015-22	Lien	No abuse of discretion	Yes	IRS
Bergdale v. Comm'r, T.C. Memo. 2014-152	Lien	No abuse of discretion since TP did not provide information requested	No	IRS
Blank v. Comm'r, T.C. Summ. Op. 2014-86	Levy	No abuse of discretion since TP did not provide information requested	Yes	IRS
Buczek v. Comm'r, 143 T.C. 301 (2014)	Levy	Court lacks jurisdiction to review; motion to dismiss granted	Yes	IRS
Budish v. Comm'r, T.C. Memo. 2014-239	Lien/Levy	Abuse of discretion by Appeals Officer; no analysis performed to meet balancing test; case remanded to Appeals	No	TP
Cantrell v. Comm'r, 576 F. App'x 439 (5th Cir. 2014), *aff'g* T.C. Memo. 2012-257, *cert. denied*, 135 S. Ct. 1881 (2015)	Levy	No abuse of discretion since TP did not provide information requested and failed to contact revenue agent; IRS acceptance of check from TP does not constitute settlement	No	IRS
Caudle v. Comm'r, T.C. Memo. 2014-196, *aff'd*, 603 F. App'x 220 (4th Cir. 2015)	Lien/Levy	No abuse of discretion since TP did not provide information requested	Yes	IRS
Clifford v. Comm'r, T.C. Memo. 2014-248	Lien	No abuse of discretion since TP had assets in excess of offer amount; TP noncompliant with current tax obligations	Yes	IRS
Coker v. Comm'r, T.C. Summ. Op. 2014-72	Levy	No abuse in discretion since TP did not provide information requested	Yes	IRS
Cropper v. Comm'r, T.C. Memo. 2014-139, *appeal docketed*, No. 15-9003 (10th Cir. Feb. 19, 2015)	Levy	TP precluded from challenging underlying liability; no abuse of discretion in denying face-to-face hearing	Yes	IRS
Crosswhite v. Comm'r, T.C. Memo. 2014-179	Levy	TP precluded from challenging underlying liability; case remanded to Appeals for further consideration and to allow TP to propose new collection alternative	No	TP
Cunningham v. Comm'r, T.C. Memo. 2014-200	Lien/Levy	No abuse of discretion in denying collection alternatives since TP did not provide information requested	Yes	IRS
Day v. Comm'r, T.C. Memo. 2014-215, *appeal docketed*, No. 14-73745 (9th Cir. Dec. 8, 2014)	Levy	No abuse of discretion since TPs (H&W) did not provide information requested; no abuse of discretion in denying face-to-face hearing	Yes	IRS
Depree v. Comm'r, T.C. Memo. 2015-40	Levy	TP precluded from challenging underlying liability; no abuse of discretion; TP did not provide information requested for collection alternative to be considered	Yes	IRS
Doonis v. Comm'r, T.C. Memo. 2014-168	Levy	No abuse of discretion in denying collection alternative since TP was noncompliant with filing tax returns	No	IRS
Duarte v. Comm'r, T.C. Memo. 2014-176	Lien/Levy	Abuse of discretion could not be determined from administrative record; case remanded to Appeals for further consideration of offer and collection actions	No	TP

TABLE 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Eichler v. Comm'r, 143 T.C. 30 (2014)	Levy	No abuse of discretion in issuing "Notice of Intent to Levy" while installment agreement was pending; case remanded to Appeals to determine economic hardship	No	Split
Frierson-Harris v. Comm'r, T.C. Memo. 2015-94, *appeal docketed*, No. 15-1294 (D.C. Cir. Aug. 24, 2015)	Lien	No abuse of discretion; TP did not provide information requested for collection alternative to be considered	Yes	IRS
Garber v. Comm'r, T.C. Memo. 2015-14	Levy	No abuse of discretion in denying collection alternative; TPs (H&W) could not show economic hardship	Yes	IRS
Gentile v. Comm'r, 592 F. App'x 824 (11th Cir. 2014), *aff'g* T.C. Memo. 2013-175	Levy	No abuse of discretion; TP precluded from challenging underlying liability	Yes	IRS
Green v. Comm'r, T.C. Memo. 2014-180	Lien	No abuse of discretion; TPs (H&W) did not provide information requested	Yes	IRS
Gurule v. Comm'r, T.C. Memo. 2015-61	Levy	Case remanded to Appeals due to underdeveloped administrative record and a material change in TPs' (H&W) ability to pay	Yes	TP
Gyorgy v. Comm'r, 779 F.3d 466 (7th Cir. 2015), *aff'g* T.C. Docket No. 19240-11 (Mar. 25, 2013)	Lien	No abuse of discretion since IRS mailed notices to last known address of TP; TP precluded from challenging underlying liability	No	IRS
Harrison v. Comm'r, T.C. Summ. Op. 2014-69	Levy	No abuse of discretion	Yes	IRS
Hauptman v. Comm'r, T.C. Memo. 2014-214, *appeal docketed*, No. 15-1071 (8th Cir. Jan. 14, 2015)	Levy	No abuse of discretion in rejecting offer	No	IRS
Hill v. Comm'r, T.C. Memo. 2014-134	Lien/Levy	No abuse of discretion; TP made frivolous arguments	Yes	IRS
Hosie v. Comm'r, T.C. Memo. 2014-246, *appeal docketed*, No. 15-70318 (9th Cir. Feb. 2, 2015)	Lien/Levy	No abuse of discretion in denying collection alternatives or in declining to withdraw notice of lien	No	IRS
Howell v. Comm'r, T.C. Memo. 2014-212	Levy	No abuse of discretion since TP did not provide information requested and did not appear at hearing	Yes	IRS
Johnson v. Comm'r, T.C. Summ. Op. 2014-90	Lien	TP precluded from challenging underlying liability; no abuse of discretion since TP did not provide information requested	Yes	IRS
Kanofsky v. Comm'r, T.C. Memo. 2015-34, *appeal docketed*, No. 15-2244 (2d Cir. July 9, 2015)	Levy	TP precluded from challenging underlying liability; no abuse of discretion; TP made frivolous arguments	Yes	IRS
Karagozian v. Comm'r, 595 F. App'x 87 (2d Cir. 2015), *aff'g* T.C. Memo. 2013-164, *petition for cert. filed*, No. 15-312 (U.S. Sept. 8, 2015)	Levy	No abuse of discretion; TP responsible for the underlying liability; decision to deny equitable recoupment affirmed	No	IRS
Kaye v. Comm'r, TC. Memo. 2014-145	Levy	TP precluded from challenging underlying liability; no abuse of discretion in denying face-to-face hearing; TP made frivolous arguments	Yes	IRS
Kirkpatrick v. Comm'r, T.C. Memo. 2014-234	Levy	No abuse of discretion	No	IRS

TABLE 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Knudsen v. Comm'r, T.C. Memo. 2015-69	Levy	IRS failed to establish notices of deficiencies were mailed to TP; motion for summary judgment denied	Yes	TP
Kupersmit v. Comm'r, T.C. Memo. 2014-247	Lien	No abuse of discretion; TP did not provide information requested for collection alternative to be considered	Yes	IRS
Lacy-Thompson v. Comm'r, T.C. Memo. 2014-137	Levy	No abuse of discretion; TPs (H&W) precluded from challenging underlying liability	No	IRS
Lang v. Comm'r, T.C. Memo. 2014-183	Lien/Levy	No abuse of discretion since TP did not provide information requested; TP made frivolous arguments	Yes	IRS
Lee v. Comm'r, 144 T.C. 40 (2015)	Lien/Levy	Administrative record was underdeveloped; motion for summary judgment denied	Yes	TP
Ligman v. Comm'r, T.C. Memo. 2015-79	Levy	No abuse of discretion in rejecting installment agreement	No	IRS
Lundy v. Comm'r, T.C. Memo. 2014-209	Levy	No abuse of discretion; TPs (H&W) did not offer a collection alternative	Yes	IRS
May v. Comm'r, T.C. Memo. 2014-194	Levy	No abuse of discretion; TPs (H&W) made frivolous arguments; motion for summary judgment granted	No	IRS
McCullar v. Comm'r, T.C. Memo. 2014-150	Levy	Court lacked jurisdiction for years 2008 and 2009; TP precluded from challenging underlying tax liability; no abuse in discretion since TP did not participate in hearing	Yes	IRS
Medairy v. Comm'r, T.C. Memo. 2015-16	Lien	No abuse of discretion in rejecting installment agreement since TP did not provide information requested or meaningfully participate in hearing	Yes	IRS
Melikian v. Comm'r, T.C. Summ. Op. 2014-114	Lien	No abuse of discretion since TPs (H&W) did not show lien would impair ability to pay liability; Doctrine of equitable estoppel did not apply	Yes	IRS
Morrison v. Comm'r, T.C. Summ. Op. 2014-95	Levy	No abuse of discretion; TP was precluded from challenging underlying liability; TP's argument was frivolous	Yes	IRS
Moses v. Comm'r, T.C. Memo. 2014-220	Levy	TP responsible for underlying liability; no abuse of discretion in denying face-to-face hearing; TP made frivolous arguments and did not provide information requested	Yes	IRS
Onyango v. Comm'r, 142 T.C. 425 (2014), *appeal docketed*, No. 14-1280 (D.C. Cir. Dec. 10, 2014)	Lien/Levy	TP precluded from challenging underlying liabilities since TP refused mail	Yes	IRS
Pansier v. Comm'r, T.C. Memo. 2014-255, *aff'd*, 2015 U.S. App. LEXIS 17001 (7th Cir. 2015)	Levy	No abuse of discretion in rejecting offer	No	IRS
Patton v. Comm'r, T.C. Memo. 2015-75, *appeal docketed*, No. 15-2007 (6th Cir. Aug. 25, 2015)	Lien	No abuse of discretion; TPs (H&W) precluded from challenging underlying liabilities; TPs' (H&W) arguments were frivolous	Yes	IRS
Reinhart v. Comm'r, T.C. Memo. 2014-218	Lien	Statute of limitations had run when lien was filed against TP	No	TP
Riggs v. Comm'r, T.C. Memo. 2015-98	Lien/Levy	No abuse of discretion in denying "currently-not-collectible" status; TP had sufficient assets to pay	Yes	IRS
Robinson v. Comm'r, 572 F. App'x 846 (11th Cir. 2014), *aff'g* T.C. Docket No. 25740-11 (Dec. 17, 2012)	Levy	No abuse of discretion in denying face-to-face hearing; TP did not provide information requested; Tax court does not have to state standard of review	Yes	IRS
Robinson v. Comm'r, T.C. Memo. 2015-57	Levy	No abuse of discretion since IRS may compel liquidation of assets to satisfy liability before entering into installment agreement	Yes	IRS

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Rosenthal v. Comm'r, T.C. Memo. 2014-252	Lien/Levy	No abuse of discretion in denying TP's request for more time; no abuse of discretion in denying collection alternatives since TP did not provide information requested	No	IRS
Savoy v. Comm'r, 589 F. App'x 187 (4th Cir. 2015), *aff'g* T.C. Memo. 2014-162	Lien/Levy	No abuse of discretion in determining TP was "currently-not-collectible" status	Yes	IRS
Scholz v. Comm'r, T.C. Memo. 2015-2	Levy	No abuse of discretion in denying collection alternative since TP did not provide information requested	No	IRS
Smith v. Comm'r, T.C. Memo. 2015-60	Levy	TP precluded from challenging underlying liability	No	IRS
Triola v. Comm'r, T.C. Memo. 2014-166	Lien/Levy	TPs (H&W) precluded from challenging underlying liability; collection action was properly sustained	No	IRS
Witmyer v. Comm'r, T.C. Memo. 2015-17	Levy	TP precluded from challenging underlying liability; no abuse of discretion in denying installment agreement since TP did not provide information requested	Yes	IRS
Wyatt v. Comm'r, T.C. Summ. Op. 2015-31	Levy	TP entitled to challenge underlying liabilities; TP received cancellation of indebtedness income	Yes	IRS
Yari v. Comm'r, 143 T.C. 157 (2014), *appeal docketed*, No. 14-73914 (9th Cir. Dec. 22, 2014)	Levy	Court had jurisdiction to review the amount of the penalty for failure to report listed transaction and upheld IRS's calculation of the penalty.	No	IRS
Yuska v. Comm'r, T.C. Memo. 2015-77	Lien	Notice of determination invalid since TP had opened bankruptcy proceedings	Yes	TP
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedule C, E, F)				
Ding v. Comm'r, T.C. Memo. 2015-20	Lien	TP entitled to challenge underlying liabilities; IRS motion for summary judgment denied	No	TP
Greenoak Holdings Ltd. v. Comm'r, 143 T.C. 170 (2014)	Levy	Court lacked jurisdiction to review	No	IRS
Grace Found. v. Comm'r, T.C. Memo. 2014-229	Levy	Collection action was properly sustained	No	IRS
Hull v. Comm'r, T.C. Memo. 2015-86	Levy	No abuse of discretion in denying collection alternative since TPs (H&W) were not in compliance and had history of noncompliance	No	IRS
King v. Comm'r, T.C. Memo. 2015-36, *appeal docketed*, No. 15-2439 (7th Cir. July 8, 2015)	Lien	Abuse of discretion for refusing to abate interest from the period of 4/13/2009 to 6/10/2009; no abuse of discretion for refusing to abate interest during the period that TAS worked on TP's case	Yes	Split
Kipp v. Comm'r, T.C. Memo. 2015-7	Levy	No abuse of discretion in denying collection alternative since TPs (H&W) did not provide information requested	Yes	IRS
Langley v. Comm'r, T.C. Memo. 2015-11	Levy	Collection action was properly sustained	Yes	IRS
Portwine v. Comm'r, T.C. Memo. 2015-29, *appeal docketed*, No. 15-9004 (10th Cir. May 27, 2015)	Lien/Levy	TP precluded from challenging underlying liability; no abuse of discretion in denying face-to-face hearing since TP did not provide information requested	Yes	IRS
Sanfilippo, Estate of v. Comm'r, T.C. Memo. 2015-15	Levy	Settlement officer did not meaningfully consider collection alternative; case remanded to Appeals	No	TP
Skallerup v. Comm'r, T.C. Memo. 2015-48	Lien	TP precluded from challenging underlying liability; Collection action was properly sustained	Yes	IRS
Stallings Greenhouse & Nursery, LLC v. Comm'r, T.C. Memo. 2015-62	Lien	No abuse of discretion; TP did not provide information requested for collection alternative to be considered; TP precluded from challenging underlying liability	No	IRS

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Synergy Envtl., Inc. v. Comm'r, T.C. Memo. 2014-140	Lien	Abuse of discretion; case remanded to Appeals to consider offer	No	TP
Uribe v. Comm'r, T.C. Memo. 2014-116	Lien/Levy	No abuse of discretion in declining to withdraw lien; remanded to Appeals to consider collection alternatives	No	Split
Valteau, Harris, Koenig & Mayer v. Comm'r, T.C. Memo. 2014-144	Lien/Levy	Collection action was properly sustained	No	IRS
Walker v. Comm'r, T.C. Memo. 2014-187	Lien	No abuse of discretion since TP did not provide information requested	No	IRS

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

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Bowers v. Comm'r, T.C. Memo. 2014-130	6651(a)(1), (2), 6654 - failed to establish reasonable cause; failed to argue inability to pay; no 6654 exception applied	Yes	IRS
Cavallaro v. Comm'r, T.C. Memo. 2014-189, *appeal docketed*, No. 15-1368 (1st Cir. Mar. 24, 2015)	6651(a)(1) - TPs (H&W) acted with reasonable cause in relying upon return preparer	No	TP
El v. Comm'r, 144 T.C. No. 9 (2015)	6651(a)(1), (2) - TP failed to present evidence of reasonable cause for failure to file; IRS failed to meet its burden of production for failure to pay penalty	Yes	Split
Filzer v. Comm'r, T.C. Memo. 2014-241	6651(a)(2), 6654 - IRS's motions for default and dismissal granted; TP failed to meet burden of establishing any error in IRS determinations	Yes	IRS
Fisher v. Comm'r, T.C. Memo. 2014-219	6651(a)(1), (2), 6654 - failed to establish reasonable cause; no 6654 exception applied	Yes	IRS
Hoeffner v. Comm'r, 587 F. App'x 147 (5th Cir. 2014), *aff'g* T.C. Docket No. 25760-12 (Nov. 26, 2013)	6651(a)(1), (2) - TPs' (H&W) claims of restricted communications with accountant, inaccessibility of records, complex tax issues, preoccupation with extensive litigation and reliance on attorney did not establish reasonable cause	No	IRS
Hurd, Estate of, U.S. v., 115 A.F.T.R.2d (RIA) 389 (C.D. Cal. 2015)	6651(a)(2) - failed to establish reasonable cause	No	IRS
King Mountain Tobacco Co., U.S. v., 114 A.F.T.R.2d (RIA) 5923 (E.D. Wash. 2014), *appeal docketed*, No. 14-36055 (9th Cir. Dec. 11, 2014)	6651(a)(2) - reliance on advice from tax professional did not establish reasonable cause	No	IRS
Kupersmit v. Comm'r, T.C. Memo. 2014-129	6651(a)(1), (2), 6654 - IRS unresponsiveness to TP's request for guidance did not establish reasonable cause for failure to file; no evidence of inability to pay; no 6654 exception applied	Yes	IRS
Kuretski v. Comm'r, 755 F.3d 929 (D.C. Cir. 2014), *aff'g* T.C. Memo. 2012-262, *cert. denied*, 135 S. Ct. 2309 (2015)	6651(a)(2) - failed to present evidence of reasonable cause	No	IRS
Le Beau v. Comm'r, T.C. Memo. 2014-198, *appeal docketed*, No. 15-70489 (9th Cir. Feb. 18, 2015)	6651(a)(1) - failed to present evidence of reasonable cause	Yes	IRS
Liftin, Estate of v. U.S., 754 F.3d 975 (Fed. Cir. 2014), *aff'g* 111 Fed. Cl. 13 (2013)	6651(a)(1) - TP reliance on attorney did not establish reasonable cause	No	IRS
Milbourn v. Comm'r, T.C. Memo. 2015-13	6651(a)(1) - TP travel and inaccessibility of records did not establish reasonable cause	No	IRS
Palmer v. Comm'r, T.C. Memo. 2015-30	6651(a)(1), (2), 6654 - difficulty in accessing records did not establish reasonable cause for failure to file; failure to argue inability to pay tax; no 6654 exception applied	Yes	IRS
Robertson v. Comm'r, T.C. Memo. 2014-143, *appeal docketed*, No. 15-1623 (4th Cir. June 9, 2015)	6651(a)(1), (2), 6654 - TP failed to establish reasonable cause for failure to file; IRS did not meet its burden of production for failure to pay penalty; IRS met its burden of production for 6654 penalty	Yes	Split
Salmonson v. Comm'r, T.C. Memo. 2014-244	6651(a)(1) - failed to present evidence of reasonable cause	Yes	IRS

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

Case Citation	Issue(s)	*Pro Se*	Decision
Salzer v. Comm'r, T.C. Memo. 2014-188	6651(a)(1), (2), 6654 - failed to establish reasonable cause; appropriateness of 6654 exceptions depend on recalculations; IRS conceded deductions, lowering penalties	Yes	Split
Sawyer v. Comm'r, T.C. Summ. Op. 2014-110	6651(a)(1), (2) - TP's legal dispute did not establish reasonable cause	Yes	IRS
Specht v. U.S., 115 A.F.T.R.2d (RIA) 357 (S.D. Ohio 2015), *appeal docketed*, No. 15-3095 (6th Cir. Feb. 6, 2015)	6651(a)(1) - TPs' (co-fiduciaries of estate) reliance on deception of attorney did not establish reasonable cause	No	IRS
Vaughn v. U.S., 34 F. Supp.3d 773 (N.D. Ohio 2014), *appeal docketed*, No. 14-3858 (6th Cir. Sept. 2, 2014)	6651(a)(1), (2) - TP reliance on financial advisors and their embezzlement did not establish reasonable cause	No	IRS
Waltner v. Comm'r, T.C. Memo. 2014-133	6651(a)(1) - failure to file due to willful neglect	No	IRS
In re Wilson, 115 A.F.T.R.2d (RIA) 971 (Bankr. N.D. Cal. 2015)	6651(a)(1) - failure to file penalty discharged by bankruptcy	No	TP
In re Witcher, 114 A.F.T.R.2d (RIA) 6246 (Bankr. D.C. 2014)	6651(a)(1), (2) - TP testimony of timely mailing is inadequate to prove IRS receipt; failure to pay tax penalty applied to period prior to bankruptcy; failure to establish reasonable cause	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trust, and Sole Proprietorships – Schedules C, E, F)			
Akey v. Comm'r, T.C. Memo. 2014-211	6651(a)(1), (2) - medical issues did not establish reasonable cause for failure to file; failed to argue inability to pay	Yes	IRS
Anyanwu v. Comm'r, T.C. Memo. 2014-123	6651(a)(1) - failed to establish reasonable cause	Yes	IRS
Baker v. Comm'r, T.C. Memo. 2014-122	6651(a)(1), (2), 6654 - TP failed to establish reasonable cause; no 6654 exceptions applied	Yes	IRS
Balice v. Comm'r, T.C. Memo. 2015-46, *appeal docketed*, No. 15-2366 (3d Cir. June 5, 2015)	6651(a)(1), (2) - failure to file and failure to pay due to willful neglect; TP's arguments were frivolous	Yes	IRS
Bennett v. Comm'r, T.C. Memo. 2014-256, *appeal docketed*, No. 15-71228 (9th Cir. Apr. 21, 2015)	6651(a)(2) - failed to present evidence of reasonable cause	Yes	IRS
Boring v. Comm'r, T.C. Summ. Op. 2014-105	6651(a)(1) - failed to argue reasonable cause	Yes	IRS
Central Motorplex, Inc. v. Comm'r, T.C. Memo. 2014-207	6651(a)(1), (2) - reliance on return preparer did not establish reasonable cause	No	IRS
Chelsea Brewing Co., U.S. v., 114 A.F.T.R.2d (RIA) 5348 (S.D.N.Y. 2014), *modified by* 114 A.F.T.R.2d (RIA) 6132 (S.D.N.Y 2014)	6651(a)(2) - undue hardship argument did not establish reasonable cause	No	IRS
Cherizol v. Comm'r, T.C. Memo. 2014-119	6651(a)(1) - failed to argue reasonable cause	Yes	IRS
Coburn v. Comm'r, T.C. Memo. 2014-113	6651(a)(1) - failed to present evidence of reasonable cause	No	IRS
Crawford v. Comm'r, T.C. Memo. 2014-156	6651(a)(1) - IRS failed to establish untimely filing	Yes	TP
Hall v. Comm'r, T.C. Memo. 2014-171	6651(a)(1) - failed to establish reasonable cause	Yes	IRS
Hillman v. Comm'r, T.C. Memo. 2014-250	6651(a)(1) - failed to establish reasonable cause	Yes	IRS
Kernan v. Comm'r, T.C. Memo. 2014-228, *appeal docketed*, No. 15-70574 (9th Cir. Feb. 25, 2015)	6651(a)(1), (2), 6654 - failed to argue reasonable cause or for 6654 exception	Yes	IRS
Kinuthia v. Comm'r, T.C. Memo. 2014-127	6651(a)(1), (2) - failed to present evidence of reasonable cause	Yes	IRS

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

Case Citation	Issue(s)	*Pro Se*	Decision
Martynuk, U.S. v., 115 A.F.T.R.2d (RIA) 613 (S.D.N.Y. 2015), *appeal docketed*, No. 15-946 (2d Cir. Mar. 27, 2015)	6651(a)(1), (2), 6654 - failed to establish reasonable cause	No	IRS
Miller v. Comm'r, T.C. Memo. 2014-105	6651(a)(1), (2), 6654 - failed to present evidence of reasonable cause; no 6654 exceptions applied	Yes	IRS
Moses v. Comm'r, T.C. Memo. 2014-220	6651(a)(1), (2), 6654 - TP failed to argue reasonable cause; no 6654 exceptions applied	Yes	IRS
Mottahedeh v. Comm'r, T.C. Memo. 2014-258	6651(a)(1), (2), 6654 - failed to argue reasonable cause for 6654 exception	Yes	IRS
Moyer v. Comm'r, T.C. Memo. 2015-45	6651(a)(1), (2), 6654 - failed to argue reasonable cause for 6654 exception	Yes	IRS
Muncy v. Comm'r, T.C. Memo. 2014-251, *appeal docketed*, No. 15-1626 (8th Cir. Mar. 26, 2015)	6651(a)(2), 6654 - TP failed to argue reasonable cause; IRS failed to establish filing requirement for one year; no 6654 exception applied for remaining years	Yes	Split
Nichols, U.S. v., 115 A.F.T.R.2d (RIA) 1971 (E.D. Wash. 2015)	6654 - failure to pay estimated tax penalty does not apply to zero returns	No	TP
Peterson v. Comm'r, T.C. Memo. 2015-1, *appeal docketed*, No. 15-73092 (9th Cir. Oct. 8, 2015)	6651(a)(1) - family illness did not establish reasonable cause	Yes	IRS
Rader v. Comm'r, 143 T.C. 376 (2014)	6651(a)(1), (2), 6654 - failed to establish reasonable cause; no 6654 exception applied; TPs' arguments were frivolous; IRS amendment to increase penalty amounts were rejected	Yes	Split
Ripley-Duggan v. Comm'r, T.C. Summ. Op. 2014-111	6651(a)(1), (2), 6654 - medical issues did not establish reasonable cause; no 6654 exceptions applied	No	IRS
Ross v. Comm'r, T.C. Summ. Op. 2014-68	6651(a)(1) - failed to present evidence of reasonable cause	Yes	IRS
Safakish v. Comm'r, T.C. Memo. 2014-242, *appeal docketed*, No. 15-70826 (9th Cir. Mar. 17, 2015)	6651(a)(1) - failed to argue reasonable cause	Yes	IRS
Sievers v. Comm'r, T.C. Memo. 2014-115	6651(a)(1), (2) - failed to argue reasonable cause	Yes	IRS
Sodipo v. Comm'r, T.C. Memo. 2015-3, *appeal docketed*, No. 15-2089 (4th Cir. Sept. 16, 2015)	6651(a)(1), (2) - unavailability of records did not establish reasonable cause	Yes	IRS
Stebbins v. Comm'r, T.C. Summ. Op. 2015-10	6651(a)(1) - TP failed to establish reasonable cause; failure to timely file returns was the result of willful neglect	Yes	IRS
Stuller, Estate of v. U.S., 55 F. Supp. 3d 1091 (C.D. Ill. 2014), *appeal docketed*, No. 15-1545 (7th Cir. Mar. 13, 2015)	6651(a)(1) - TP's (W & estate of H, S-Corp) destruction and misplacement of records due to fire, medical illness, and death of H did not establish reasonable cause	No	IRS
Stuller, Estate of v. U.S., 115 A.F.T.R.2d 1025 (C.D. Ill. 2014), *appeal docketed*, No. 15-1545 (7th Cir. Mar. 13, 2015)	6651(a)(1) - TP did not establish reasonable cause	No	IRS
Tarighi v. Comm'r, T.C. Summ. Op. 2015-28	6651(a)(1) - failed to establish reasonable cause	Yes	IRS
TFT Galveston Portfolio, LTD. v. Comm'r, 144 T.C. 96 (2015)	6651(a)(1), (2) - failed to establish reasonable cause	No	IRS
Topsnik v. Comm'r, 143 T.C. 240 (2014), *appeal docketed*, No. 15-1251 (D.C. Cir. July 29, 2015)	6651(a)(1), (2), 6654 - failed to present evidence of reasonable cause; amount of failure to pay penalty reduced for one tax year due to corrected calculation	No	Split
Valteau, Harris, Koenig & Mayer v. Comm'r, T.C. Memo. 2014-144	6651(a)(1), (2) - financial hardship claim did not establish reasonable cause	No	IRS

Case Citation	Issue(s)	*Pro Se*	Decision
Villarreal v. Comm'r, T.C. Summ. Op. 2014-87	6651(a)(1) - TPs' (H&W) belief that no tax was due did not establish reasonable cause	Yes	IRS
Villegas v. Comm'r, T.C. Memo. 2015-33	6651(a)(1), (2), 6654 - TPs' (H&W) belief no tax was due and reliance on tax preparer did not establish reasonable cause; no 6654 exceptions applied	Yes	IRS
Wheeler v. Comm'r, T.C. Memo. 2014-204	6651(a)(1), (2), 6654 - failed to argue reasonable cause; no 6654 exceptions applied; failure to pay estimated tax penalty does not apply to zero return for one tax year	Yes	Split
Wyatt v. Comm'r, T.C. Summ. Op. 2015-31	6651(a)(2), 6654 - financial hardship claim did not establish reasonable cause; no 6654 exceptions applied	Yes	IRS

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

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Azarian, U.S. v., 115 A.F.T.R.2d (RIA) 439 (N.D. Tex. 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Baker, U.S. v., 114 A.F.T.R.2d (RIA) 5772 (D.N.H. 2014)	Federal tax liens invalid; transfer of real property complete to TP (W) via divorce decree prior to assessment against TP (H)	No	TP
Carter, U.S. v., 606 F. App'x 464 (10th Cir. 2015), *aff'g* 113 A.F.T.R.2d (RIA) 2383 (D.N.M. 2014)	Affirmed lower court's decision to foreclose	Yes	IRS
Davis, U.S. v., 115 A.F.T.R.2d (RIA) 1692 (E.D. Mich. 2015), *granting partial summary judgment*, 114 A.F.T.R.2d (RIA) 6019 (E.D. Mich. 2014), *appeal docketed*, No. 15-1696 (6th Cir. June 17, 2015)	Denied TP's motion for reconsideration of decision to foreclose on TPs' (H&W) jointly owned real property	No	IRS
Davis, U.S. v., 114 A.F.T.R.2d (RIA) 6019 (E.D. Mich. 2014), *reconsideration denied by* 115 A.F.T.R.2d (RIA) 1692 (E.D. Mich. 2015), *appeal docketed*, No. 15-1696 (6th Cir. June 17, 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) jointly held real property	No	IRS
Limanni, U.S. v., 115 A.F.T.R.2d (RIA) 1149 (D.N.H. 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	Yes	IRS
Long, U.S. v., 2014 U.S. Dist. LEXIS 184514 (N.D. Ohio 2014)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
Martin, U.S. v., 116 A.F.T.R.2d (RIA) 5008 (D. Haw. 2015), *appeal docketed*, No. 15-16815 (9th Cir. Sept. 14, 2015)	Federal tax liens valid and foreclosed against TP's real property	No	IRS
Martinez, U.S. v., 115 A.F.T.R.2d (RIA) 2017 (W.D. Tex. 2015)	Federal tax liens valid and foreclosed against TP's real property	No	IRS
McGrew, U.S. v., 114 A.F.T.R.2d (RIA) 7031 (C.D. Cal. 2014), *appeal docketed*, No. 15-55078 (9th Cir. Jan. 14, 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Molina, U.S. v., 114 A.F.T.R.2d (RIA) 5206 (D.P.R. 2014)	Federal tax liens valid and foreclosed against TP's one half interest in real property	No	IRS
Payne, U.S. v., 115 A.F.T.R.2d (RIA) 475 (N.D. Ohio 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Porath, U.S. v., 115 A.F.T.R.2d (RIA) 1575 (E.D. Cal. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1156 (E.D. Cal. 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	Yes	IRS
Winsper, U.S. v., 114 A.F.T.R.2d (RIA) 5218 (W.D. Ky. 2014)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Worley, U.S. v., 592 F. App'x 100 (3d Cir. 2015), *aff'g* 113 A.F.T.R.2d (RIA) 861 (M.D. Pa. 2014)	Affirmed lower court's decision to foreclose	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedule C, E, F)			
Ali, U.S. v., 115 A.F.T.R.2d (RIA) 891 (E.D. Pa. 2015)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
Bogart, U.S. v., 114 A.F.T.R.2d (RIA) 5474 (M.D. Tenn. 2014), *adopting in part*, 114 A.F.T.R.2d (RIA) 5469 (M.D. Tenn. 2014), *aff'g* Docket No. 14-6225 (6th Cir. June 29, 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property; property held by corporate nominee	Yes	IRS

TABLE 7: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Bogart, U.S. v., 115 A.F.T.R.2d (RIA) 1201 (M.D. Pa. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1190 (M.D. Pa. 2015), *appeal docketed*, No. 15-2363 (3d Cir. June 5, 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property, trust held property as nominee	Yes	IRS
Boyce, U.S. v., 38 F.Supp.3d 1135 (C.D. Cal 2014), *appeal docketed*, No. 14-56610 (9th Cir. Oct.6, 2014)	Federal tax liens valid and foreclosed against TPs' (H&W) jointly owned real property; property held by TPs' corporate nominee; fraudulent conveyance of property set aside	Yes	IRS
Cardaci, U.S. v., 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014), *appeal docketed*, No. 14-4237 (3d Cir. Oct. 27, 2014)	Foreclosure of tax liens denied; alternate collection ordered based on one-half of the fair rental value for real property	No	TP
Church of Northwest Ark., U.S. v., 114 A.F.T.R.2d (RIA) 6418 (W.D. Ark. 2014)	Default judgment against TP and third parties; federal tax liens valid and foreclosed against TP's real property	No	IRS
Clinkscale, U.S. v., 114 A.F.T.R.2d (RIA) 5544 (N.D. Ohio 2014)	Federal tax liens valid and foreclosed against TPs' (H&W) jointly owned real property	No	IRS
Cucinello, U.S. v., 115 A.F.T.R.2d (RIA) 1357 (D. Alaska 2015)	Federal tax liens valid and foreclosed against TP's real property; property held by TP's nominee	No	IRS
Davis, U.S. v., 114 A.F.T.R.2d (RIA) 6977 (S.D. Ohio 2014), *adopting* 114 A.F.T.R.2d (RIA) 6975 (S.D. Ohio 2014)	Federal tax liens valid and foreclosed against TP's real property	No	IRS
DeBeck v. U.S., 2014 U.S. Dist. LEXIS 127085 (W.D. Tex. 2014), *aff'd in part and dismissed in part by* 2015 U.S. App. LEXIS 14365 (5th Cir. 2015)	Federal tax liens valid and foreclosed against TP's real property; all corporations and entities were TP's nominees; transfer of business to one nominee deemed illegal	No	IRS
Dudley, U.S. v., 2014 U.S. Dist. LEXIS 180431 (E.D. Mo. 2014)	Federal tax liens valid and foreclosed against TPs' (H&W) jointly owned real property	Yes	IRS
Edwards, U.S. v., 114 A.F.T.R.2d (RIA) 5622 (S.D. Ohio 2014), *modified by* 114 A.F.T.R.2d (RIA) 6214 (S.D. Ohio 2014)	Federal tax liens valid and foreclosed against TP's real property	No	IRS
Edwards, U.S. v., 114 A.F.T.R.2d (RIA) 6214 (S.D. Ohio 2014), *modifying* 114 A.F.T.R.2d (RIA) 5622 (S.D. Ohio 2014)	Erroneous facts in prior proceeding revealed; IRS does not have first priority lien and foreclosure rendered meaningless for IRS	No	TP
Eichhorn Stained Glass, Inc., U.S. v., 114 A.F.T.R.2d (RIA) 6281 (W.D. Ky. 2014), *appeal docketed*, No. 15-5834 (6th Cir. Aug. 5, 2015)	Federal tax liens valid for all quarters at issue except third quarter of 2000; foreclosed against TP's one-third interest in real property held as tenancy in common	No	Split
Elmore, U.S. v., 586 F. App'x 310 (9th Cir. 2015), *aff'g* 110 A.F.T.R.2d (RIA) 5223 (W.D. Wash. 2012)	Affirmed lower court's decision to foreclose	No	IRS
Fraughton, U.S. v., 115 A.F.T.R.2d (RIA) 1017 (D. Utah 2015), *adopting* 115 A.F.T.R.2d (RIA) 882 (D. Utah 2015), *appeal docketed*, No. 15-4103 (10th Cir. July 24, 2015)	Default judgment against TP; federal tax liens valid and foreclosed against TP's real property; property held by corporate nominee	Yes	IRS
Green, U.S. v., 115 A.F.T.R.2d (RIA) 1262 (N.D. Okla. 2015), *appeal docketed*, No. 15-5032 (10th Cir. Apr. 20, 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property; transfer to trust void	Yes	IRS
Gunnink, U.S. v., 115 A.F.T.R.2d (RIA) 1073 (D. Minn. 2015), *adopting* 115 A.F.T.R.2d (RIA) 1062 (D. Minn. 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) jointly owned real property; property held by TPs' corporate nominee	Yes	IRS
Hiatt, U.S. v., 114 A.F.T.R.2d (RIA) 5874 (S.D. Ind. 2014)	Federal tax liens valid and foreclosed against TP's (W) half interest in jointly owned real property; transfer to TP (H) fraudulent	No	IRS
Johnson, U.S. v., 115 A.F.T.R.2d (RIA) 1210 (W.D. Wash. 2015)	Federal tax liens valid and foreclosed against TP's real property; property held by TP's corporate nominee	No	IRS

TABLE 7: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Jones, U.S. v., 114 A.F.T.R.2d (RIA) 6126 (D. Wyo. 2014)	Federal tax liens valid and foreclosed against TP's real property; property held by TP's corporate nominee	Yes	IRS
Martynuk, U.S. v., 115 A.F.T.R.2d (RIA) 613 (S.D.N.Y. 2015), *appeal docketed*, No. 15-946 (2d Cir. Mar. 27, 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Novell, U.S. v., 114 A.F.T.R.2d (RIA) 6457 (W.D. Mo. 2014), *aff'd by* 607 F. App'x 600 (8th Cir. 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) jointly owned real property; property held by TPs' corporate nominee	Yes	IRS
O'Shea, U.S. v., 115 A.F.T.R.2d (RIA) 887 (S.D.W. Va. 2015), *aff'd by* 116 A.F.T.R.2d (RIA) 5389 (4th Cir. 2015)	Federal tax liens valid and foreclosed against TPs' (H&W, daughter) real property; trusts were nominees	Yes	IRS
Perrow, U.S. v., 115 A.F.T.R.2d (RIA) 743 (D. Ariz. 2015), *adopting* 115 A.F.T.R.2d (RIA) 739 (D. Ariz. 2014)	Federal tax liens valid and foreclosed against TP's real property	Yes	IRS
Peters, U.S. v., 113 A.F.T.R.2d (RIA) 2501 (E.D. Mo. 2014)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Rozbruch, U.S. v., 28 F.Supp.3d 256 (S.D.N.Y. 2014), *appeal docketed*, No. 14-4330 (2d Cir. Nov. 20, 2014)	Federal tax liens valid and foreclosed against TPs' (H&W) real property	No	IRS
Thompson, U.S. v., 115 A.F.T.R.2d (RIA) 1152 (D. Neb. 2015), *appeal docketed*, No. 15-2263 (8th Cir. June 10, 2015)	Federal tax liens valid and foreclosed against TPs' (H&W) real property; trust was nominee	Yes	IRS
Wilkins, U.S. v., 2015 U.S. Dist. LEXIS 48478 (M.D. Fla. 2015), *appeal docketed*, No. 15-14346 (11th Cir. Sept. 29, 2015)	Federal tax liens valid and foreclosed against TP's real property; property held by TP's corporate nominee	No	IRS

TABLE 8 Charitable Contributions Under IRC § 170

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Anyanwu v. Comm'r, T.C. Memo. 2014-123	Cash contributions mostly substantiated	Yes	TP
Dannon v. Comm'r, 571 F. App'x 514 (8th Cir. 2014), *aff'g* T.C. Docket No. 029245-12 (Nov. 19, 2013)	Cash and non-cash contributions unsubstantiated	Yes	IRS
Flores v. Comm'r, T.C. Memo. 2015-9	Cash contribution unsubstantiated	Yes	IRS
Howe v. Comm'r, T.C. Summ. Op. 2015-26	Non-cash contribution unsubstantiated	Yes	IRS
Jalloh v. Comm'r, T.C. Summ. Op. 2015-18	Cash and non-cash contributions unsubstantiated	Yes	IRS
Jermihov v. Comm'r, T.C. Summ. Op. 2014-75	Cash contributions lacked substantiation; however, some deduction allowed	Yes	TP
Kalapodis v. Comm'r, T.C. Memo. 2014-205	TPs (H&W) who established a trust to pay educational expenses were not entitled to a charitable contribution deduction for amounts distributed from the trust to students for educational purposes	Yes	IRS
Koriakos v. Comm'r, T.C. Summ. Op. 2014-70	Cash contributions lacked substantiation; however, some deduction allowed; non-cash contributions unsubstantiated	Yes	Split
Kunkel v. Comm'r, T.C. Memo. 2015-71	Non-cash contributions unsubstantiated	Yes	IRS
Lain v. Comm'r, T.C. Summ. Op. 2015-5	Cash and non-cash contributions lacked substantiation; however, some deduction allowed	Yes	TP
Legaspi v. Comm'r, T.C. Summ. Op. 2015-14	Non-cash contribution unsubstantiated	Yes	IRS
Longino v. Comm'r, 593 F. App'x 965 (11th Cir. 2014), *aff'g* T.C. Memo. 2013-80	Cash contribution unsubstantiated	Yes	IRS
McCarty v. Comm'r, T.C. Summ. Op. 2014-81	Cash and non-cash contributions lacked substantiation; however, some deduction allowed	Yes	TP
U.S. v. Nichols, 115 A.F.T.R.2d (RIA) 1971 (E.D. Wash. 2015)	Cash and non-cash contributions unsubstantiated for multiple tax years; some deductions allowed in some years	No	Split
Scheidelman v. Comm'r, 755 F.3d 148 (2d Cir. 2014), *aff'g* T.C. Memo. 2013-18	Architectural façade easement did not reduce the fair market value of home	No	IRS
Smith v. Comm'r, T.C. Memo. 2014-203	Non-cash contributions unsubstantiated	Yes	IRS
Thomas-Kozak v. Comm'r, T.C. Summ. Op. 2014-104	Non-cash contributions unsubstantiated	No	IRS
Zarlengo v. Comm'r, T.C. Memo. 2014-161	Valuation of façade easement; easement was not protected in perpetuity until the following tax year	No	Split
Business Taxpayers (Corporate, Partnerships, Trusts, and Sole Proprietorships - Schedules C, E, F)			
Balsam Mountain Invs., LLC v. Comm'r, T.C. Memo. 2015-43, *appeal docketed*, No. 15-2010 (4th Cir. Sept. 3, 2015)	Conservation easement is not "qualified real property interest"	No	IRS
Belk v. Comm'r, 774 F.3d 221 (4th Cir. 2014), *aff'g* 140 T.C. 1 (2013)	Conservation easement was not "qualified real property interest"	No	IRS
Costello v. Comm'r, T.C. Memo. 2015-87	Qualified appraisal did not meet all requirements and conservation easement was conveyed as part of a *quid pro quo* exchange	No	IRS
Davis v. Comm'r, T.C. Memo. 2015-88	"Bargain sale" contribution substantiated; deduction amount must reflect fair market value	No	TP

TABLE 8: Charitable Contributions Under IRC § 170

Case Citation	Issue(s)	*Pro Se*	Decision
Mitchell v. Comm'r, 775 F.3d 1243 (10th Cir. 2015), *aff'g* 138 T.C. 324 (2012)	Conservation easement was not protected in perpetuity	No	IRS
Reri Holdings I, LLC v. Comm'r, 143 T.C. 41 (2014)	Valuation of charitable contribution should be the successor member interest in LLC, not the property owned by LLC's wholly owned subsidiary	No	IRS
Schmidt v. Comm'r, T.C. Memo. 2014-159	Valuation of conservation easement	No	TP
Seventeen Seventy Sherman St., LLC v. Comm'r, T.C. Memo. 2014-124	Failure to identify or value consideration received in *quid pro quo* transaction prohibits charitable contribution deduction for conservation easements	No	IRS
SWF Real Estate LLC v. Comm'r, T.C. Memo. 2015-63	Valuation of conservation easement	No	TP
Whitehouse Hotel Ltd. P'ship v. Comm'r, 755 F.3d 236 (5th Cir. 2014), *aff'g in part, vacating in part* 139 T.C. 304	Valuation of conservation easement	No	IRS

TABLE 9 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
Individual Taxpayers (But Not Sole Proprietorships)				
Bowers v. Comm'r, T.C. Memo. 2014-130	TP petitioned for redetermination of deficiency and additions to tax and argued the employees who issued the notice of deficiency and substitute for return did not have the proper authority	Yes	TP	
Hill v. Comm'r, T.C. Memo. 2014-134	TP petitioned for review of IRS decision to sustain levy action and file an NFTL and argued that he was not a withholding agent or engaged in earning income from a trade or business	Yes	TP	
Lang v. Comm'r, T.C. Memo. 2014-183	TP petitioned for review of determination to sustain an NFTL and maintained proceedings primarily for delay	Yes	TP	
May v. Comm'r, T.C. Memo. 2014-194	TPs (H&W) petitioned for review of IRS decision to sustain a levy and asserted the proposed assessments were invalid because they were not properly signed and the delegation of authority order did not accompany the assessments	No	IRS	$500
Patton v. Comm'r, T.C. Memo. 2015-75, *appeal docketed*, No. 15-2007 (6th Cir. Aug. 25, 2015)	TPs (H&W) petitioned for review of IRS decision to uphold a NFTL and argued they were unable to comply with their tax obligations due to water trespass on their property by the government	Yes	IRS	$3,500
Waltner v. Comm'r, T.C. Memo. 2014-133	TPs (H&W) petitioned for redetermination of deficiency and penalty and asserted frivolous arguments	No	IRS	$10,000
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)				
Balice v. Comm'r, T.C. Memo. 2015-46, *appeal docketed*, No. 15-2366 (3d Cir. June 5, 2015)	TP petitioned for redetermination of deficiency and argued he is not subject to deficiency procedures and wages are not income	Yes	IRS	$25,000
Banister v. Comm'r, T.C. Memo. 2015-10, *appeal docketed*, No. 15-71103 (9th Cir. Apr. 9, 2015)	TP petitioned for redetermination of deficiency, additions to tax and penalties, and argued that his U.S. income is not subject to taxation, he had no obligation to file an income tax return, and a statutory notice of deficiency must be signed	Yes	IRS	$25,000
Bennett v. Comm'r, T.C. Memo. 2014-256, *appeal docketed*, No. 15-71228 (9th Cir. Apr. 21, 2015)	TP petitioned for redetermination of penalties and argued that his U.S. income is not subject to taxation and he had no obligation to file income tax returns	Yes	IRS	$25,000
Kanofsky v. Comm'r, T.C. Memo. 2015-34, *appeal docketed*, No. 15-2244 (2d Cir. July 9, 2015)	TP petitioned for review of IRS decision to uphold notice of intent to levy and asserted international conflicts have bearing on his case, his status as a whistleblower is impacting his case, exempt organization issues are causing delay and corrupt and fraudulent community actions are blocking his business dealings	Yes	IRS	$20,000
Kanofsky v. Comm'r, T.C. Memo. 2014-153, *aff'd*, 116 A.F.T.R.2d (RIA) 5186 (3d Cir. 2015)	TP petitioned for review of IRS decision to sustain a NFTL and asserted government corruption, fraud, and his status as a whistleblower were impacting his case	Yes	IRS	$10,000
Kanofsky v. Comm'r, T.C. Memo. 2015-70, *appeal docketed*, No. 15-1778 (4th Cir. July 14, 2015)	TP petitioned for review of IRS decision to uphold NFTL and collect unpaid income tax and asserted he was prevented by corrupt governments and a crime wave from pursuing his business	Yes	IRS	$20,000
Kernan v. Comm'r, T.C. Memo. 2014-228, *appeal docketed*, No. 15-70574 (9th Cir. Feb. 25, 2015)	TP petitioned for redetermination of deficiency and additions to tax and argued the Commissioner never personally notified him of a duty to file tax returns	Yes	TP	

TABLE 9: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
Miller v. Comm'r, T.C. Memo. 2014-105	TP petitioned for redetermination of deficiency and instituted proceedings mainly for delay	Yes	TP	
Muncy v. Comm'r, T.C. Memo. 2014-251, *appeal docketed*, No. 15-1626 (8th Cir. Mar. 26, 2015)	TP petitioned for redetermination of deficiency and additions to tax and argued the notices of deficiency were invalid because they were not sent by an authorized delegate of the Secretary	Yes	TP	
Portwine v. Comm'r, T.C. Memo. 2015-29, *appeal docketed*, No. 15-9004 (10th Cir. May 27, 2015)	TP petitioned for review of determination to sustain lien and levy actions and instituted proceedings primarily for delay	Yes	TP	
Rader v. Comm'r, 143 T.C. 376 (2014)	TPs (H&W) petitioned for redetermination of deficiency and additions to tax and argued that the substitutes for return were invalid and asserted a Fifth Amendment claim against self-incrimination	Yes	IRS	$10,000
Section 6673 Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments				
El v. Comm'r, 144 T.C. No. 9 (2015)	TP petitioned for redetermination of deficiency and additions to tax and asserted frivolous arguments	Yes		
Kaye v. Comm'r, T.C. Memo. 2014-145	TP petitioned for review of determination to proceed with levy and asserted frivolous arguments	Yes		
Salmonson v. Comm'r, T.C. Memo. 2014-244	TP petitioned for redetermination of deficiency, additions to tax, and penalties and asserted frivolous arguments	Yes		
Salzer v. Comm'r, T.C. Memo. 2014-188	TP petitioned for redetermination of deficiency and additions to tax and asserted he could not pay taxes to a country that adopted a socialist government	Yes		
U.S. Courts of Appeals' Decisions on Appeal of Section 6673 Penalties Imposed by U.S. Tax Court				
Byers v. Comm'r, 577 F. App'x 622 (8th Cir. 2014), *aff'g* T.C. Docket No. 015841-11 (July 9, 2013)	Penalty affirmed	Yes	IRS	
U.S. Courts of Appeals' Decisions on Sanctions Under Section 7482 (c)(4), FRAP Rule 38, or Other Authority				
Carlson v. Comm'r, 604 F. App'x 628 (9th Cir. 2015), *aff'g* T.C. Memo. 2012-76	TP appealed Tax Court's redetermination of deficiency decision and filed an appeal lacking merit	Yes	IRS	$8,000
Taliaferro v. Freeman, 595 F. App'x 961 (11th Cir. 2014), *aff'g Taliaferro v. U.S.*, 113 A.F.T.R.2d (RIA) 1840 (M.D. Ga. 2014)	TP appealed dismissal of his case and argued he is not a taxpayer, is not subject to taxation, the Sixteenth Amendment only authorizes excise taxes, levies can only be used against federal employees, he is a nonresident alien subject to tax only on income from a trade or business, levies violate his Fourth Amendment and Fifth Amendment rights	Yes	IRS	$6,252
Trowbridge, U.S. v., 591 F. App'x 298 (5th Cir. 2015), *aff'g* Docket No. 4:14-CV-00027 (S.D. Tex. May 22, 2014), *cert. denied*, 135 S. Ct. 2816 (2015)	TP appealed grant of summary judgment and argued he is not a U.S. citizen and that Harris County, TX is not in the U.S.	Yes	IRS	$8,000
Section 7482 (c)(4), FRAP Rule 38, or Other Authority Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments				
Graffia v. Comm'r, 580 F. App'x 474 (7th Cir. 2014), *aff'g* T.C. Memo. 2013-211	TPs (H, W, son and daughter-in-law) appealed Tax Court's decision in the redetermination of deficiency and penalties and asserted frivolous challenges to the Tax Court's determinations	Yes		

TABLE 10 Relief from Joint and Several Liability Under IRC § 6015

Case Citation	Issue(s)	*Pro Se*	Intervenor	Decision
Blomberg v. Comm'r, T.C. Summ. Op. 2014-82	6015(f) (understatement)	Yes	No	IRS
Brodskiy v. Comm'r, T.C. Summ. Op. 2015-8	6015(c) (understatement); IRS granted relief but intervenor objected	Yes	Yes	TP
Davidson v. Comm'r, 144 T.C. No. 13 (2015)	6015(e) - TP's motion to voluntarily withdraw petition for innocent spouse redetermination was granted	Yes	No	TP
Demeter v. Comm'r, T.C. Memo. 2014-238	6015(f) (underpayment); IRS conceded issue but intervenor objected	No	Yes	TP
Deihl v. Comm'r, 115 A.F.T.R.2d (RIA) 895 (9th Cir. 2015), *aff'g* T.C. Memo. 2012-176	6015(c),(f) (understatement)	No	No	IRS
Ehrmann v. Comm'r, T.C. Summ. Op. 2014-96	6015(f) (underpayment)	Yes	No	IRS
Farka v. Comm'r, T.C. Summ. Op. 2014-73	6015(b),(c),(f) (understatement)	Yes	No	Split
Hall v. Comm'r, T.C. Memo. 2014-171	6015(b),(f) (understatement)	Yes	No	IRS
Hammernik v. Comm'r, T.C. Memo. 2014-170	6015(f) (underpayment)	Yes	No	IRS
In re Mikels, 524 B.R. 805 (Bankr. S.D. Ind. 2015)	Bankruptcy court did not have jurisdiction to make a determination of innocent spouse relief under 6015(f)	No	No	IRS
Jackson v. Comm'r, T.C. Summ. Op. 2014-63	6015(f) (underpayment)	Yes	Yes	IRS
Johnson v. Comm'r, T.C. Memo. 2014-240	6015(f) (underpayment)	Yes	Yes	IRS
Molinet v. Comm'r, T.C. Memo. 2014-109	6015(f) (underpayment); IRS conceded issue but intervenor objected	No	Yes	TP
Nunez v. Comm'r, 599 F. App'x 629 (9th Cir. 2015), *aff'g* T.C. Docket No. 15168-10 (Feb. 15, 2013)	Tax Court did not lose jurisdiction when the IRS no longer opposed relief under 6015(f) (underpayment)	No	No	IRS
Palomares v. Comm'r, T.C. Memo. 2014-243, *appeal docketed*, No. 15-70659 (9th Cir. Mar. 3, 2015)	6015(f) (underpayment); statutory time for claiming a refund had expired	No	No	IRS
Panetta v. Comm'r, T.C. Summ. Op. 2015-16	6015(c),(f) (understatement)	No	No	IRS
Pejoski v. Comm'r, T.C. Summ. Op. 2014-98	6015(b) (understatement); IRS conceded issue but intervenor objected	Yes	Yes	TP
Sanchez v. Comm'r, T.C. Summ. Op. 2015-20	6015(a) (understatement); no joint return existed	No	No	IRS
Sorrentino v. Comm'r, T.C. Summ. Op. 2014-99	6015(a) (understatement); no joint return existed	No	Yes	IRS
U.S. v. Hirsch, 114 A.F.T.R.2d (RIA) 5896 (E.D.N.Y. 2014)	6015(f) (underpayment)	Yes	No	TP
Varela v. Comm'r, T.C. Memo. 2014-222	6015(b) (understatement); IRS conceded issue but intervenor objected	No	Yes	TP
Wang v. Comm'r, T.C. Memo. 2014-206	6015(b),(f) (understatement)	No	Yes	IRS
Work v. Comm'r, T.C. Memo. 2014-190	6015(b),(c),(f) (understatement)	No	No	IRS
Zelasko v. Comm'r, T.C. Summ. Op. 2014-52	6015(b),(c),(f) (understatement)	No	Yes	Split

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