Area of Focus #1 The IRS Should Provide Victims of Identity Theft with a True Single Point of Contact to Help Them Resolve Their Account Problems and Obtain Their Refunds

TAXPAYER RIGHTS IMPACTED[1]

- *The right to quality service*
- *The right to a fair and just tax system*

Stolen Identity Cases Continue to Top the List of TAS Case Receipts

In general, tax-related identity theft (IDT) 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.[2] Through improved filters and screening, the IRS has been able to detect and stop more than 3.8 million suspicious tax returns in the 2015 filing season (through May 31).[3] The largest component of these suspended returns is a result of the Taxpayer Protection Program (TPP), which we discussed in detail in the Filing Season Review section of this report, *supra*. With a false positive rate of 34 percent, approximately one out of three returns suspended by the TPP were legitimate returns.[4]

The frustration of taxpayers impacted by the TPP was exacerbated by the extreme difficulty of reaching a live assistor when taxpayers called the phone number they were instructed to dial. The chart below shows the level of service on the TPP phone line during the 2015 filing season; in some of the busiest weeks of the filing season, less than one in ten callers were able to reach an IRS assistor.[5]

1 *See* IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

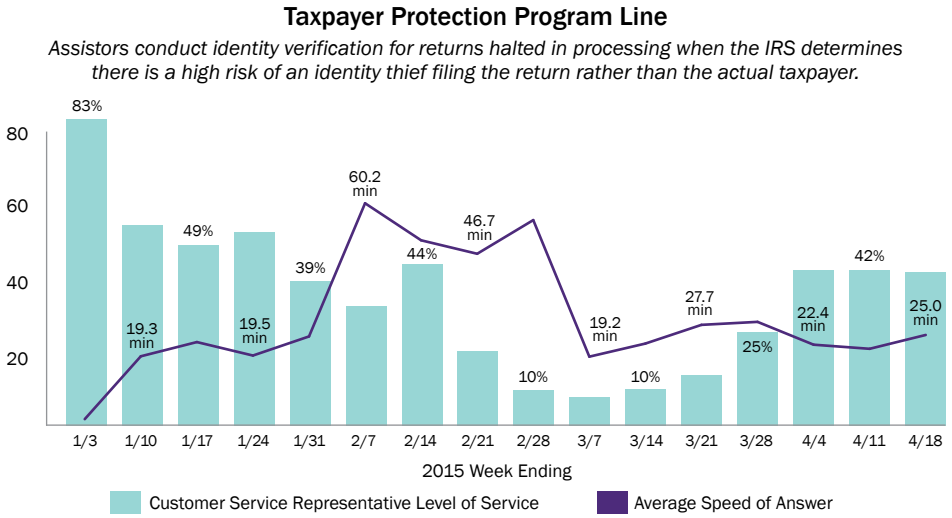
2 *See* IRM 10.5.3.1.2.1(4), *Identity Protection Program Servicewide Identity Theft Guidance* (Dec. 17, 2014).

3 IRS, *Global Identity Theft Report* (May 31, 2015).

4 IRS, *IRS Return Integrity & Compliance Services (RICS), Update of the Taxpayer Protection Program (TPP)* 9 (June 24, 2015).

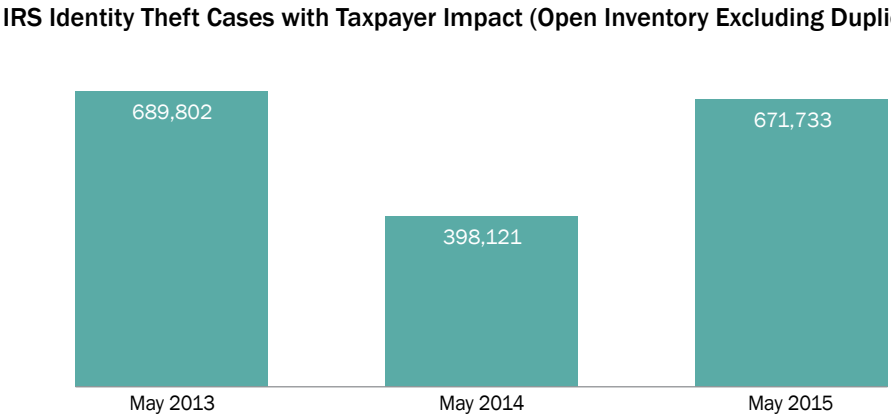
5 The IRS attributes the low level of service (LOS) for the TPP line to a number of factors, including budget challenges that impacted all toll-free lines and multiple weather-related closures in TPP call sites. Additional staff for TPP were trained and added in late March to improve LOS.

FIGURE 3.1.1[6]



Given the false positive rate, it is no wonder the IRS continues to see a significant number of IDT cases. As of the end of May 2015, the IRS had 671,773 IDT cases with taxpayer impact (excluding duplicates) in its open inventory, up 69 percent from 398,121 in May 2014.[7] The rising IDT inventory, reaching 2013 levels, indicates the IRS is losing any gains made by recent process improvements, most likely due to the overreach of the TPP filters and understaffing of the TPP phone lines.[8]

FIGURE 3.1.2[9]



6 IRS, Joint Operations Center, *TPP Snapshot Reports* (Jan.–Apr. 2015).

7 IRS, *Global Identity Theft Report* (May 31, 2015); IRS, *Global Identity Theft Report* (May 31, 2014).

8 IRS, Joint Operations Center, FY 2015 Weekly TPP Snapshot, reports for weeks ending Jan. 3–Apr. 18, 2015; IRS, Return Integrity & Correspondence Services (RICS), *Update of the Taxpayer Protection Program (TPP)* 9 (Apr. 30, 2014); IRS, RICS, *Update of the Taxpayer Protection Program (TPP)* 11 (June 24, 2015).

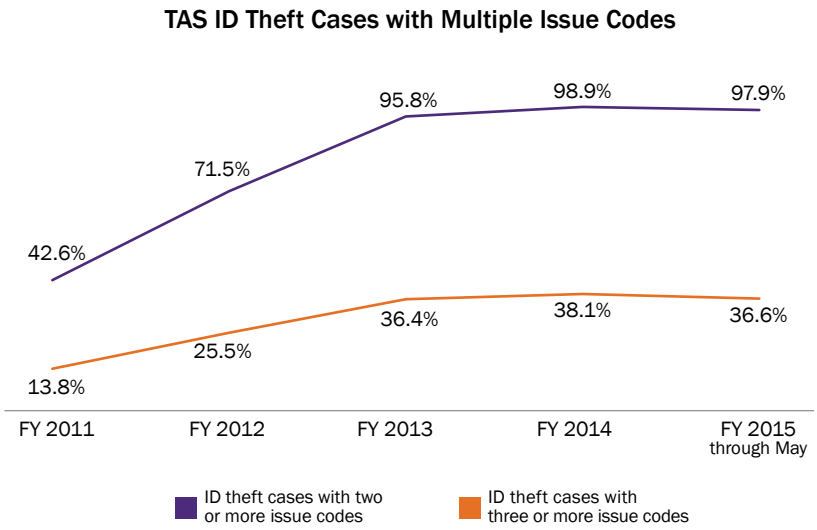
9 IRS, *Global Identity Theft Report* (May 31, 2015); IRS, *Global Identity Theft Report* (May 31, 2014); IRS, *Global Identity Theft Report* (May 31, 2013).

During the first two quarters of fiscal year (FY) 2015, TAS received 23,657 IDT cases (24 percent of all TAS receipts).[10] This represents a 27 percent increase in IDT case receipts from the same period in FY 2014, when such cases accounted for 20 percent of all TAS cases.[11] Stolen identity cases are still by far the most common type of case within TAS, accounting for 91 percent more cases than the second most common issue through the second quarter of FY 2015.[12] As discussed in the Filing Season Review section of this report, nearly half of TAS's IDT cases received this filing season involved an unpostable or reject issue.[13] *TAS has received more IDT cases during the months of February, March, and April 2015 than it received during the same time period in any of the past three years*, which suggests much of the fallout from the high TPP false positive rate and low level of service on the TPP phone lines was borne by TAS.[14]

Identity Theft Cases Are Complex, Often Involving Multiple Issues

Another reason why some IDT cases end up in TAS is their complexity, often requiring actions by employees from different IRS organizations and with different skills. In many instances, TAS Case Advocates must address more than two issues to fully resolve an IDT victim's case,[15] as the chart below illustrates.

FIGURE 3.1.3[16]



However, as complex as these IDT cases have become, Case Advocates have learned to resolve these cases more efficiently. In FY 2015 through May, TAS has taken an average of 66 days to close IDT cases,

10 TAS Business Performance Review (2nd Quarter FY 2015).

11 TAS Business Performance Review (2nd Quarter FY 2014).

12 TAS Business Performance Review (2nd Quarter FY 2015).

13 See *Filing Season Review, supra.*

14 Data provided by TAS Technical Analysis and Guidance (on file with TAS).

15 When TAS opens a case, it assigns a primary issue code based on the most significant issue, policy or process within the IRS that needs to be resolved. When a TAS case has multiple issues to resolve, a secondary issue code will be assigned. See IRM 13.1.16.13.1.1, *Taxpayer Issue Code* (Feb. 1, 2011).

16 Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; June 1, 2015).

compared to 126 days over the same period in FY 2010. TAS achieved a relief rate of 80 percent in IDT cases in FY 2015 (through May), compared to 78 percent for non-IDT TAS cases.[17]

IRC § 7811 authorizes the National Taxpayer Advocate (or her delegate)[18] to issue a Taxpayer Assistance Order (TAO) to require the IRS to cease any action, take any action as permitted by law, or refrain from taking any action, when a taxpayer is suffering (or about to suffer) a significant hardship. In FY 2015 (through May), TAS issued four TAOs on identity theft-related issues. The IRS complied with three of the TAOs, and TAS rescinded one.[19]

IRS Needs a True Sole Point of Contact to Interact with the Taxpayer and Oversee Complex Identity Theft Cases

Identity theft is an invasive crime. Victims of such a traumatic event should not be bounced around from one IRS function to another, recounting their experience time and again to various employees. Thus, it is imperative the IRS offer victims a sole point of contact who will work with various IRS functions behind the scenes and remain the single contact with the victim throughout the case. This recommendation is consistent with our findings in our 2014 IDT case study (published in the National Taxpayer Advocate 2014 Annual Report to Congress volume 2), which showed requiring IDT victims to deal with multiple assistors significantly added to the time it took to fully resolve IDT cases.[20]

In FY 2015, the IRS plans to reorganize its IDT victim assistance units under one "umbrella" within Wage and Investment (W&I). This reorganization provides the IRS a perfect opportunity to set up a sole point of contact system for IDT victims with complex cases. The W&I Commissioner has committed to the National Taxpayer Advocate once the "umbrella" organization is established, she will seriously consider TAS's recommendations in this regard.[21] In its official response to our recommendations in the 2014 Annual Report to Congress, reported in Volume 2 of this report, the IRS states that as part of its IDT victim assistance re-engineering efforts, it will assess the feasibility of the recommendation to assign a sole point of contact.[22] The National Taxpayer Advocate will continue to advocate for this single-contact-employee approach, but she believes it may require congressional action for the IRS to adopt this common sense approach.

> It is imperative the IRS offer victims a sole point of contact who will work with various IRS functions behind the scenes and remain the single contact with the victim throughout the case.

The IRS Needs to Develop a Method to Track and Reduce Identity Theft Servicewide Cycle Time from the Taxpayer's Perspective

While some IRS functions can track the time a case is in their inventory, the IRS still cannot provide a servicewide cycle time measure for resolving identity theft cases. The specialized IDT units generally measure cycle time solely from the date they receive the case; their cycle time measures do not reflect the time

17 Data obtained from TAMIS (June 1, 2010; June 1, 2015).

18 The National Taxpayer Advocate has delegated the authority to issue TAOs to Local Taxpayer Advocates. *See* IRM 1.2.50.2, *Delegation Order 13-1* (Rev. 1) (Mar. 17, 2009).

19 Data obtained from TAMIS (June 1, 2015).

20 National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 52-3.

21 *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 55, for a complete list of recommendations to improve IDT victim assistance.

22 *See* IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2014 Annual Report to Congress vol. 2, 84–7, *infra.*

elapsed since the taxpayer filed his or her tax return or all of the interactions the taxpayer had with the IRS before that function received the case. If Accounts Management, for example, claims its cycle time is down to 120 days, all that means is it took 120 days for that particular function to resolve that particular issue. It does not mean the IRS resolved all of the IDT victim's tax issues in 120 days.

To get a better sense of how long the IRS takes to resolve an IDT case, TAS conducted a study published in Volume 2 of the National Taxpayer Advocate's 2014 Annual Report to Congress. In our review of a representative sample of IRS IDT cases closed in June 2014, we found the average cycle time was 179 days.[23] The Treasury Inspector General for Tax Administration (TIGTA) recently released an audit report that corroborated our findings. TIGTA conducted a sample of 100 IDT cases and found that the average cycle time was 278 days, and those that were processed using new procedures were resolved in an average of 174 days.[24]

The IRS maintains that current procedures require its employees to perform a global account review upon IDT case receipt to identify all taxpayer and account issues, and that employees assigned an IDT case are directed to resolve all account issues prior to case closure.[25] Yet in our 2014 case study, we found 22 percent of the IDT cases were closed while there were still one or more unresolved issues, which calls into question the effectiveness of the current global account review procedures. With more than one in five IDT cases closed prematurely, the 179-day IDT case cycle time we reported is most certainly understated.

When taxpayers must wait six months or more for the IRS to resolve their IDT-related tax issues, it can cause a significant hardship, especially for victims awaiting tax refunds. The burden is on the victims to call the IRS multiple times, who must explain the circumstances to a different assistor each time. Moreover, because the IRS waits until the account is fully resolved before issuing an IDT marker, an IDT victim will not receive the benefit of an Identity Protection PIN[26] during this 179-day average cycle time.

In its response to the recommendations from our 2014 IDT case study, the IRS states that TAS's suggestion to more accurately track IDT case cycle time will be assessed in re-engineering efforts slated to begin in October 2015, and that it is committed to exploring feasible options that might improve taxpayer perceptions of the time it takes to receive resolution and the overall taxpayer experience.[27] The National Taxpayer Advocate will continue to vigorously advocate on behalf of taxpayers, and will take the IRS up on its offer to work collaboratively with TAS to develop an IDT cycle time measure that is more transparent and accurately represents the time it takes for the IRS to fully resolve all of the related tax issues for IDT victims.

The IRS Is Exploring Ways to Bolster Cybersecurity and Improve Taxpayer Authentication

On the technology front, two significant challenges for the IRS are to authenticate taxpayer information and to safeguard that information. This challenge is not unique to the IRS, but is faced by organizations

23 National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 53.

24 TIGTA, Ref. No. 2015-40-024, *Victims of Identity Theft Continue to Experience Delays and Errors in Receiving Refunds* 6 (Mar. 20, 2015).

25 *See* IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2014 Annual Report to Congress vol. 2, 84–7, *infra.*

26 An Identity Protection PIN is a six-digit code that must be entered on the tax return at time of filing by certain victims of IDT. This Identity Protection PIN protects accounts from being susceptible to further misuse by identity thieves. See *IRM* 10.5.3.2.15, *Identity Protection Personal Identification Number (IP PIN)* (Dec. 17, 2014).

27 *See* IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2014 Annual Report to Congress vol. 2, 84–7, *infra.*

with responsibility for collecting and safekeeping sensitive personal information. For example, up to 18 million individuals were impacted when the Office of Personnel Management's database was breached in early June.[28] This data breach occurred on the heels of hackers accessing the IRS's "Get Transcript" web application to obtain sensitive tax information of approximately 104,000 taxpayers.[29]

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No organization can guarantee it will be 100 percent secure – especially if hackers obtained answers to knowledge-based questions from other sources, as they did in the "Get Transcript" incident – but the IRS can and should do more to bolster its cybersecurity and regain the trust of taxpayers. To that end, the IRS has partnered with various agencies and private sector companies to exchange ideas at a security summit organized by the IRS. As a result of these meetings, the IRS may learn of better ways to authenticate taxpayers, which should lead to fewer IDT victims. We applaud the IRS's efforts and look forward to reviewing any proposals that come out of the security summit.

FOCUS FOR FISCAL YEAR 2016

- Continue to work with the IRS on IDT issues, recommending improvements and alternative approaches, with a particular focus on reducing the time it takes to achieve complete and accurate resolution of the case from the victim's perspective;
- Collaborate with W&I as it implements the reorganization of the IDT victim assistance units to ensure their efficacy, and advocate for establishing sole employee contacts for complex identity theft cases;
- Review the global account review process the IRS performs prior to closing IDT cases and make recommendations for improvement;
- Instruct Local Taxpayer Advocates to issue TAOs in appropriate cases to expedite relief to taxpayers when IRS processes are inadequate or too lengthy to assist taxpayers who are suffering from a significant hardship;
- Improve our own case processing procedures by timely alerting Case Advocates of any changes in IRS procedures to avoid delays in correcting the taxpayer's accounts; and
- Elevate emerging IDT schemes and processing issues identified in TAS casework for collaborative solutions with the IRS.

28 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.

29 IRS, *IRS Statement on the "Get Transcript" Application, available at* http://www.irs.gov/uac/Newsroom/IRS-Statement-on-the-Get-Transcript-Application (last viewed June 25, 2015); Jared Serbu, *IRS Searches for New Authentication Measures in Wake of Huge Data Breach*, Federal News Radio, June 3, 2015, *available at* http://federalnewsradio.com/technology/2015/06/irs-searches-for-new-authentication-measures-in-wake-of-huge-data-breach/.

Area of Focus #2 The IRS Agrees It Should Issue Refunds to Victims of Return Preparer Fraud, But It Has Been Slow to Develop Necessary Procedures

TAXPAYER RIGHTS IMPACTED[1]

- *The right to pay no more than the correct amount of tax*
- *The right to a fair and just tax system*

Victims of Return Preparer Fraud Are Treated Differently Than Victims of Identity Theft

Many taxpayers enlist the aid of tax return preparers[2] to meet their increasingly complex tax return filing obligations. Unfortunately, a small percentage of these preparers betray their clients' trust by inflating income, deductions, credits, or withholding without the clients' knowledge or consent.[3] They then pocket all or part of the taxpayer's direct deposit refund by diverting all or part of the money to a bank account under the preparer's control.

In situations where the preparer diverted the legitimate portion of the refund to his or her own account, victimized taxpayers have little hope of obtaining their refunds from the preparer, who may have closed up shop. While there is no legal impediment to the IRS issuing refunds to victims of preparer fraud, it has been reluctant to do so. Taxpayers who are trying to comply with the law and have demonstrated they were not complicit in the fraud should receive their full refunds, just as victims of identity theft do.

Return preparer fraud is similar to identity theft in that both crimes delay refunds and cause account problems, but the IRS deals with the victims in substantially different ways. Over the years, the IRS has developed procedures that ultimately undo the harm to victims of identity theft. The IRS can "back out" the return filed by the perpetrator, process the legitimate return, and pay the associated refund claim, if applicable, even if the IRS has already paid that refund out to the identity thief.[4]

In contrast, the IRS still has no procedures that fully unwind the harm suffered by victims of preparer fraud. In June 2012, the IRS issued interim guidance to its employees on how to handle certain preparer fraud cases in the form of Servicewide Electronic Research Program (SERP) Alert 12A0417.[5] However, this guidance was not comprehensive, as it failed to provide relief for a large category of victims. For example, the IRS agreed to remove the fraudulent tax return information from the victim's account and

1 See IRS, *Taxpayer Bill of Rights, available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

2 See Internal Revenue Code (IRC) § 7701(a)(36). Approximately 60 percent of individual taxpayers paid a preparer to file their 2013 tax return. IRS Compliance Data Warehouse, Individual Returns Transaction File, (Tax Year 2013 - returns processed as of the end of April 2015).

3 See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 22 (*Return Preparer Fraud: A Sad Story*).

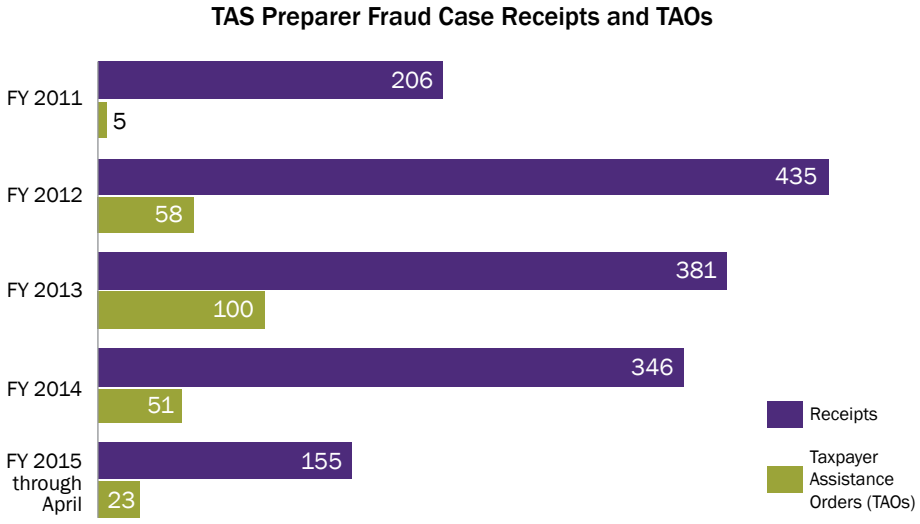
4 *See generally* Internal Revenue Manual (IRM) 21.6.2, *Individual Tax Returns, Adjusting TIN-Related Problems* (Oct. 1, 2013).

5 *See* SERP Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012). The SERP Alert was incorporated into an interim guidance memorandum, which has been reissued multiple times. *See Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012); *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0214-02 (Aug. 5, 2013); *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0814-05 (Aug. 4, 2014). Each interim guidance memorandum indicates that the procedures are interim only until IRM 21.9.3, *Assisting Victims of Return Preparer Fraud*, is published. In accordance with IRM 1.11.10.2.1(3), *Interim Guidance Effective Period* (Apr. 25, 2014), when the interim guidance cannot be incorporated into the IRM before the expiration date on the memorandum, the IRS must reissue the interim guidance. To date, the IRS has not published IRM 21.9.3, and the current interim guidance will expire on August 5, 2015.

process the victim's correct return, but it did not instruct its employees to issue a replacement refund – which, from the taxpayer's perspective, is the most important step.

In fiscal year (FY) 2011, TAS started tracking return preparer fraud cases using a special code. As shown below, TAS has continued to work a substantial number of cases in which taxpayers are harmed by return preparer fraud or misconduct.

FIGURE 3.2.1[6]



As of April 30, 2015, TAS had 308 return preparer fraud cases in inventory.[7] Some of the victims who have come to TAS for help have been waiting for refunds since they filed their 2008 tax returns.[8]

Although IRS Leadership Has Agreed It Would Issue Refunds to Victims of Return Preparer Fraud, the IRS Has Not Developed Any Procedures to Date

While working to help these individual taxpayers, TAS has also pursued this issue from a systemic perspective. Since 2011, the National Taxpayer Advocate has raised and discussed this issue with four

6 Pursuant to IRC § 7811, the National Taxpayer Advocate may issue a Taxpayer Assistance Order ordering the IRS to cease, take, or refrain from taking certain actions as described more fully in the statute. The order may be modified or rescinded only by the Commissioner or Deputy Commissioner or the National Taxpayer Advocate (or her delegate). Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (FY 2011-2013 - Oct. 24, 2013; FY 2014 - May 28, 2015; FY 2015 - May 19, 2015).

7 Data obtained from TAMIS (May 19, 2015). The current inventory of return preparer fraud cases includes unresolved cases received in prior FYs.

8 *See, e.g.,* TAMIS case numbers 4757753, 5269873, and 5361465.

Commissioners (two acting), issued two Taxpayer Advocate Directives (TADs),[9] one Proposed TAD,[10] and covered the subject extensively in her Annual Reports to Congress.[11]

What is frustrating is that return preparer fraud is not a novel issue, as the IRS has known for many years about this problem and its severe impact on victims. Since 2000, the IRS has received four legal opinions from its Office of Chief Counsel that, when read together, permit the IRS to:

- Disregard the altered return filed by the preparer;
- Accept an unaltered return signed by the taxpayer; and
- Issue a refund to the victim even if the IRS had already made a payment to the preparer.[12]

In 2014, the Office of Chief Counsel reaffirmed to the National Taxpayer Advocate and to the IRS Commissioner that the IRS is not prohibited from issuing refunds to victims of preparer fraud.

Taxpayers who are trying to comply with the law and have demonstrated they were not complicit in the fraud should receive their full refunds, just as victims of identity theft do.

The National Taxpayer Advocate has urged the IRS leadership to make these vulnerable taxpayers whole, just as the IRS works to make identity theft victims whole. The 2013 Annual Report to Congress proposed a framework of analysis that takes into account mitigation, restitution, and substantiation the IRS can use in deciding when to issue refunds to purported victims of preparer fraud.[13]

In March 2014, the Commissioner decided the IRS will issue refunds to victims who can show they were not complicit in the preparer's fraud. Under this approach, the victim must provide a copy of an incident report filed with local law enforcement (*i.e.,* a police report) before the IRS issues a replacement refund, to alleviate the IRS's concern about collusion between the preparer and the taxpayer.

It has now been over a year since the Commissioner made this decision and the IRS still has not implemented this policy. On June 15, 2015, the Deputy Commissioner for Services and Enforcement issued a memorandum to the National Taxpayer Advocate stating the Wage and Investment division (W&I) would be sharing draft procedures with TAS within a week. This memo included a decision document outlining the conditions that need to be met for a preparer fraud victim to be eligible for a refund.[14] W&I shared with TAS on June 23, 2015, draft procedures for resolving return preparer misconduct cases. At the time of publication of this report, the National Taxpayer Advocate is conducting a thorough review of these procedures and will provide

9 Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a TAD "to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment[,] or provide an essential service to taxpayers." IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). *See also* IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

10 *See* IRM 13.2.1.6.1.2, *Proposed TAD* (July 16, 2009).

11 *See, e.g.,* National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 22-34; National Taxpayer Advocate 2013 Annual Report to Congress 94-102; National Taxpayer Advocate 2012 Annual Report to Congress 68-94.

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

13 National Taxpayer Advocate 2013 Annual Report to Congress 100-101.

14 *See* Return Preparer Misconduct Decision Document (updated May 26, 2015). W&I shared with TAS on June 23, 2015, draft internal guidance memorandum containing procedures for resolving return preparer misconduct cases. At the time of publication of this report, National Taxpayer Advocate is conducting a thorough review of these procedures and will provide comments to W&I.

comments to W&I. One point the National Taxpayer Advcoate will emphasize is the need to build into the procedures the ability for IRS employees to exercise discretion, when appropriate, and analyze the particular facts and circumstances of each preparer fraud case, rather than use a "checklist" approach. We have seen too many cases where the facts may not fit squarely into a box, and it would be grossly unfair for the IRS to deny relief to these taxpayers (many who have been waiting patiently for refunds for upwards of three years) because they did not comply with the precise documentation requirements that have yet to be shared with the public (and thus could not have known they would have to supply to substantiate their claims).

Despite continued requests from TAS to be included in the development of these procedures, neither the Deputy Commissioner for Services and Enforcement nor the Commissioner of W&I shared the draft guidance with the National Taxpayer Advocate before issuance. Many of the concerns being identified now by the National Taxpayer Advocate could have been addressed months ago had discussions been held. This decision to withhold communication until the last minute is particularly disturbing given the National Taxpayer Advocate's leadership and advocacy in this area, and the IRS's history in not providing relief for these victims.

FOCUS FOR FISCAL YEAR 2016

- Provide comments to W&I on the draft procedures for processing return preparer misconduct claims submitted by victims of preparer fraud;
- Issue appropriate guidance to TAS employees on how to advocate for victims of return preparer fraud and what documentation should be submitted to the IRS;
- Continue to refer taxpayers to Low Income Taxpayer Clinics to evaluate options to pursue legal action;[15] and
- If necessary, continue to elevate return preparer fraud TAOs to the highest levels of the IRS.

15 In December 2014, the National Taxpayer Advocate personally wrote to each of the taxpayers whose return preparer fraud cases were in TAS's inventory, encouraging them to obtain representation from a Low Income Taxpayer Clinic and to possibly file a refund suit in a United States district court or the United States Court of Federal Claims to pursue the matter further.

Area of Focus #3 The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen

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 finality*

Overall, the IRS has done a commendable job of implementing the first stages of the Patient Protection and Affordable Care Act of 2009 (ACA), including developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies.[2] The IRS's implementation of the law was rigorously tested during this filing season, with the introduction of the Individual Shared Responsibility Payment (ISRP)[3] and the Premium Tax Credit (PTC)[4] on tax year (TY) 2014 federal returns. At the same time, the IRS received and processed a significant number of new information returns from insurers and exchanges.[5] The level of service (LOS) on the ACA telephone hotline (800-919-0452) was about 68 percent during the filing season, which far exceeded the 37 percent overall LOS on the Accounts Management (AM) toll-free lines.[6] The Filing Season Review section of this report provides preliminary high level IRS data related to the PTC, ISRP, and LOS on the ACA telephone hotline during the 2015 Filing Season.[7] However, as the filing season unfolded, we identified the issues detailed below.

1 See IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

2 Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

3 Internal Revenue Code (IRC) § 5000A. Taxpayers filing TY 2014 federal income tax returns were required to report they have "minimum essential coverage" 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.

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 and family size for the year of coverage, while the amount a taxpayer is actually eligible for is based on actual household income and family size for the year reflected on the tax return. Taxpayers were required to reconcile the credit amount they received in advance with the PTC to which they were actually entitled.

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 minimum essential coverage (as defined in section 5000A(f)) to an individual to report to the IRS information about the coverage of each individual covered under the policy. Section 6056 requires annual information reporting by applicable large employers 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) provides 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 As described above, the AM LOS of approximately 37 percent is a combined figure reflecting 29 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. The ACA line received about 567,000 attempted calls, as compared with almost 50 million on the AM lines overall during the period. IRS, Joint Operations Center (JOC), *Product Detail Report* (week ending Apr. 18, 2015); IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Apr. 18, 2015).

7 *See Filing Season Review, supra.*

IRS Implementation Efforts Were Tested During Filing Season 2015

Eligible individual taxpayers claimed the PTC for the first time on TY 2014 returns filed during the 2015 filing season. The following figure provides information regarding the extent to which individual taxpayers claimed the PTC on their TY 2014 returns.

FIGURE 3.3.1, Reporting of the Premium Tax Credit on Forms 8962 for TY 2014 Returns Through April 30, 2015[8]

Returns Filed with Forms 8962, *Premium Tax Credit (PTC)*	2.6 milion
Total PTC Amount Claimed	$7.7 billion
Average PTC Amount Claimed Per Return	$3,000
Returns Reporting Advanced PTC	2.4 million (93% of returns with Forms 8962)
Total Advanced PTC Reported	$8.7 billion
Prepared Returns Filed with Forms 8962 (Paid or Volunteer)	1.6 million

Individual taxpayers who did not have minimum essential coverage or qualify for an exemption were required to make an ISRP on their TY 2014 returns. The following table provides data on the reporting of ISRPs on TY 2014 returns.

8 Wage & Investment Research and Analysis (WIRA), *ACA Fact Sheet 5/21/2015* (returns processed through April 2015). This data is based on amounts claimed on returns that had posted as of the end of April 2015 and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2014 returns, and conducts compliance activities. Note that the number of "Returns Reporting Advanced PTC" is a subset of the number of "Returns with Forms 8962, *Premium Tax Credit (PTC)*." All taxpayers claiming the PTC were required to file a Form 8962. Of those taxpayers who have filed thus far, about 93 percent claimed the Advanced PTC (APTC), while about seven percent waited to claim the PTC until they filed their return. However, not all APTC recipients have filed returns and reconciled their credit amount. Therefore, it is difficult to compare the "Total Advanced PTC Reported" (about $8.7 billion) to the "Total PTC Amount Claimed." The difference of roughly $1 billion is probably attributable, at least in part, to some taxpayers having reported receiving more in Advanced PTC during the year than they ultimately claimed. Of the 2.6 million returns filed with Forms 8962, about 1.6 million returns were prepared by a paid or volunteer preparer and about one million were deemed self-prepared.

FIGURE 3.3.2, Reporting of the Individual Shared Responsibility Payments on TY 2014 Returns Through April 30, 2015[9]

Returns Claiming Coverage	94 million
Returns with ISRP	6.6 million
Average ISRP per Return Reporting ISRP	$190
Prepared Returns Reporting ISRP (Paid or Volunteer)	4.3 million
Returns Filed with Forms 8965, *Health Coverage Exemptions*	10.7 million
Returns Filed with Forms 8965 Claiming the Household Coverage Exemption (checked yes in Form 8965 Part II 7a or 7b or both)	3.2 million
Returns Filed with Forms 8965 Claiming Coverage Exemption (Part III)	7.5 milion
Prepared Returns Filed with Forms 8965 (Paid or Volunteer)	5.7 million (53% of returns with Form 8965)

Taxpayers Who Have Not Filed Returns by August Will Have Difficulties Receiving Advanced Premium Tax Credit

The regulations that accompany the ACA include a process for re-enrolling taxpayers in health insurance and redetermining their eligibility for the APTC.[10] As part of that process, in August the IRS will share with the exchanges a list of taxpayers who received the APTC but have not yet filed a tax return with the IRS. For all taxpayers who previously received the APTC and already filed their tax returns by the end of August, the exchanges will automatically re-enroll the taxpayers and recalculate their 2016 APTC amount during the fall of 2015. Taxpayers who failed to file a tax return by the end of August will be re-enrolled in their insurance for 2016; however, they will not receive the APTC.[11] To receive the APTC, taxpayers will have to file their 2014 tax return and then go back to the Marketplace for a redetermination of their eligibility for the APTC. This creates an extra burden on taxpayers to reestablish their eligibility for the advanced credit.

The IRS has begun sending newly-developed Letter 5591 to APTC recipients who have yet to file tax returns or extensions. The letter urges the recipient to file as soon as possible to avoid a gap in receiving 2016 APTC.[12] Unfortunately, TAS was not given the opportunity to review the letter prior to its use. We are concerned that the letter does not adequately warn taxpayers that they need to file returns by the end of August to avoid a cumbersome process to continue receiving APTC. The letter also fails to specifically tell taxpayers that if they do not file and reconcile their APTC, they will have to undergo additional steps to receive the APTC for 2016. Aside from the letter distribution, we will monitor the IRS communications strategy to educate taxpayers to file by the end of August to continue receiving APTC.

9 WIRA, *ACA Fact Sheet 5/21/2015* (returns processed through April 2015). This data is based on amounts claimed on returns that had posted as of the end of April 2015 and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2014 returns, and conducts compliance activities. Note that there were about 6.6 million returns reporting an ISRP. Of those, about 4.3 million were submitted on returns prepared by a paid or volunteer preparer and about 2.3 million were deemed self-prepared. Taxpayers also filed about 10.7 million returns claiming an exemption from the ISRP using Form 8965, *Health Coverage Exemptions*. Of those, about 53 percent were prepared by a paid or volunteer preparer and about 47 percent were deemed self-prepared. Taxpayers who report an ISRP may or may not file Form 8965. The roughly 10.7 million returns claiming an exemption on Form 8965 were divided between about 7.5 million claiming a Part III coverage exemption for individuals and about 3.2 million claiming a Part II coverage exemption for households (although some taxpayers claimed an exemption in both Part II and Part III).

10 45 CFR 155.335, Annual eligibility redetermination; Department of Health and Human Services, *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.

11 *Id.*

12 IRS, ACA Executive Steering Committee Meeting Notes (June 23, 2015).

A Significant Number of Taxpayers Overpaid the Individual Shared Responsibility Payment

As discussed in the Filing Season Review section of this report, WIRA and TAS Research have identified more than 300,000 taxpayers who overpaid their ISRP, totaling about $35 million through April 30, 2015.[13] Most of these taxpayers did not owe an ISRP because they were eligible for an exemption as a result of their low income.[14] The average ISRP overstatement amount was a little over $110 per return.[15] The IRS Office of Chief Counsel has advised the IRS has the legal authority to return the overpaid portions of the ISRP. Therefore, the IRS must make a policy call about what procedures it will require taxpayers to follow to obtain their refunds.[16] We are mindful that the IRS is operating in a low budget environment and has limited resources to develop procedures to return these funds in a proactive manner. As this report goes to print, it is our understanding that the IRS is still considering options, but has indicated that it will likely send soft notices to impacted taxpayers. As the IRS weighs the different options, the National Taxpayer Advocate raises the following concerns:

As discussed in the Filing Season Review section of this report, Wage & Investment Research and Analysis and TAS Research have identified more than 300,000 taxpayers who overpaid their ISRP, totaling about $35 million through April 30, 2015.

- For taxpayers who overpaid ISRP on balance due returns, the IRS should put a collection hold on the associated accounts to enable the IRS to make the appropriate adjustments before taking any improper collection actions; and
- Because the average overpayment was approximately $110, we are concerned many impacted taxpayers will not take the initiative to file a claim for a refund of the excess ISRP because it may not make sense to incur costly tax return preparation fees.17 We believe the IRS should proactively adjust the impacted accounts and return overpayments to the taxpayers, where appropriate, without requiring the taxpayers to request such payment.18 While the IRS could also send out a letter or soft notice to the affected taxpayers and include a partially

13 WIRA and TAS Research analysis on ISRP Overstatements through April 30, 2015, on file with TAS Research. The IRS and TAS cannot calculate the exact amount of ISRP overpayments until all dependents have filed their TY 2014 tax returns because the amount of the ISRP depends on household income pursuant to IRC § 5000A(c).

14 Nearly 250,000 of these taxpayers were eligible for an ISRP exemption. These taxpayers paid in over $27 million in ISRP. In addition, more than 50,000 taxpayers paid a total of nearly $8 million because the ISRP amount was miscalculated. These amounts include returns processed by the IRS through the end of April 2015. WIRA and TAS Research estimates from the Individual Returns Transaction File on the IRS Compliance Data Warehouse. This data is preliminary and is subject to change as the IRS reviews the data, processes additional TY 2014 returns, and conducts compliance activities.

15 This average only includes returns with an ISRP overstatement.

16 Meeting between the Office of Chief Counsel and TAS (June 3, 2015), and e-mail summary provided to TAS from the Office of Chief Counsel (June 19, 2015).

17 WIRA and TAS Research analysis on ISRP Overstatements through April 30, 2015, on file with TAS Research.

18 If possible, the checks should include language to explain what the funds represent. We understand that any letter or language provided to taxpayers, regardless of the explanation contained therein, may increase the call volume for the IRS.

pre-filled response form to allow taxpayers to claim a refund,[19] that process is extremely burdensome for taxpayers and the IRS, particularly when the IRS can make the adjustment on its own without the need for taxpayers to respond. By placing the burden on taxpayers, some taxpayers may not respond and will end up paying more tax than they owe.

Because the average overpayment was approximately $110, we are concerned many impacted taxpayers will not take the initiative to claim a refund of the excess ISRP because it may not make sense to incur costly tax return preparation fees.

TAS Tested Free File Programs to Evaluate ISRP Calculation Accuracy

Based on unusual trends on returns with self-assessed ISRPs,[20] as well as several submissions to the Systemic Advocacy Management System (SAMS) questioning return preparation software accuracy with ACA-related issues,[21] TAS tested the 14 Free File sites accessible through the official IRS website.[22] The IRS website directs taxpayers to use Free File to ensure they are complying with ACA requirements.[23] To determine the experience of taxpayers and find out if the Free File programs accurately calculate the ISRP and determine exemption[24] eligibility, we created the scenarios described below and tested them on each of the 14 Free File sites.

- Scenario 1 ("the under the filing threshold" scenario): Taxpayer 1, single with no dependents, had no health care coverage throughout the entire 2014 TY. He earns $10,000 in wages at his job with no additional income and claims the standard

19 This partially pre-filled response form would constitute an informal claim for refund, if timely signed and returned to the IRS. An "informal claim" is a request for refund submitted by the taxpayer either on a non-standard form (written request) or by some other means as long as the required claim elements are identified. These elements include TY, identification number, refund requested, and reason for the refund. The Supreme Court has embraced this concept. See *United States v. Kales,* 314 U.S. 186 (1941). *See also United States v. Memphis Cotton Oil Co.,* 288 U.S. 62 (1933). For example, a letter from the taxpayer can be an informal claim. IRM 4.90.7.1(4)(b), *Overview* (May 9, 2013). *See also Newton v. United States*, 163 F. Supp. 614 (Ct. Cl. 1958) (written protest as an informal claim). By submitting a timely informal claim for refund, the taxpayer would be protected against the expiration of the refund statute of limitations. IRC § 6511. For example, if the taxpayer does not submit an informal claim for refund but merely calls the IRS and requests the IRS to return the excess ISRP and the refund statute runs before the taxpayer realizes the IRS didn't send the correct amount, the taxpayer has no remedy; the phone call would not be a claim for purposes of IRC § 7422, and thus the taxpayer could not have a U.S. District Court or the U.S. Court of Federal Claims decide the merits of his or her refund claim.

20 The IRS ACA Joint Implementation Team on Collection conducted a preliminary study of 100 cases to determine if the ISRP was being reported and calculated correctly. The team selected cases with self-reported ISRP, but the cases were not selected from a random sample. The analysis was preliminary but found ISRP misreporting trends that warranted additional analysis. The initial review produced concerns about whether the problems resulted from software issues. Approximately 50 percent of returns with all misreported ISRP were prepared by tax return preparers. TAS notes from the February 26, 2015 and March 9, 2015 IRS Collection ACA Joint Implementation Team meetings. Based on these initial findings, TAS decided to test the Free File software programs for problems in reporting and calculating the ISRP.

21 TAS received submissions regarding either return preparers not considering possible ISRP exemptions for the taxpayer or software adding the ISRP when it appears the taxpayer is eligible for a coverage exemption. SAMS submissions 32208, 32583, and 32706.

22 Free File provides taxpayers with free commercial tax return software or fillable form options. For 2015, anyone who had income of $60,000 or less is eligible for the free tax software. For people who made more than $60,000, the Free File Alliance provides Free File Fillable Forms, the electronic version of IRS paper forms. Free File also provides free requests for extensions of time to file, with no income limitations. IRS News Release, *IRS and Free File Alliance Reach New Agreement for Free Tax Software*, IR-2015-52 (Mar. 17, 2015). We decided to test Free File programs for two reasons: (1) the programs are free of charge while performing the tests, and (2) the programs are similar to the related products commercially available through the vendors. See 2015 Free On-Line Electronic Tax Filing Agreement Amendment (Mar. 6, 2015), *available at* http://www.irs.gov/pub/irs-utl/filing_agreement_2015.pdf (last visited June 23, 2015).

23 IRS, *The Health Care Law and Your Taxes*, *available at* http://www.irs.gov/pub/irs-pdf/p5201.pdf (last visited June 23, 2015).

24 For more information about the various coverage exemptions available for 2014, see the chart in the Instructions to Form 8965, *Health Coverage Exemption*s.

deduction. This scenario was designed to determine how easy it is for taxpayers to claim the ISRP exemption for income under the threshold for filing a tax return.25

- *Scenario 2 ("the hardship exemption" scenario):* Taxpayer 2, single with no dependents, earns wages of $36,000 with no additional income and claims the standard deduction. Taxpayer 2 had no health care coverage in TY 2014 and filed for a hardship exemption with the exchange, which is still pending at the time of filing. This scenario was designed to determine the difficulty of reporting an exchange-granted ISRP exemption when the exemption certificate number is still pending.
- *Scenario 3: ("the one spouse with insurance, the other spouse without" scenario):* Taxpayer 3 is married with no dependents and had health care coverage for the entire year, but his spouse had no coverage for the entire year. Their filing status is married filing jointly, with combined wage income of $56,000. They will claim the standard deduction. This scenario was designed to determine if the software clearly explained how to calculate the ISRP when one spouse does not have coverage.

Results of the Free File Testing Produced A Few Concerns

For the most part, our tests of the Free File programs produced positive results. All but one program, discussed in more detail below, calculated the correct ISRP amount due from the taxpayer. In general, most programs were user-friendly and clearly guided the testers to understand how to calculate the ISRP or claim the appropriate exemption. Some interesting findings are:[26]

- *Automatic Exemption with No Explanation.* In four programs, the software automatically and correctly calculated no ISRP due in Scenario 1, but never informed the taxpayer he qualified for the exemption for income under the filing threshold. Thus, an educational component was missing, which might lead to compliance issues in future years, if the taxpayer's income increased.
- *Incorrect ISRP Calculation Because Form 8965 Not Supported.* 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 a $259 ISRP for Scenario 2.
- *Inadequate Guidance.* For Scenario 2, three programs assumed the user already knew about the available exemptions and did not provide sufficient guidance. For example, two programs required the user to locate and complete Form 8965 with minimal guidance to claim the hardship exemption. A third program provided a list of exemptions with no further explanations.

TAS reported detailed findings of the tests to the IRS Affordable Care Act Office as well as to Wage & Investment (W&I) Customer Account Services (CAS) to enable the IRS to discuss the results with the impacted software providers in an effort to correct any problems before the next filing season.[27] It is our understanding that the IRS coordinated with the Free File Alliance to address issues found in our tests. At the time this report went to print, we are pleased to report the software provider associated with the incorrect ISRP calculation above already adjusted the program to avoid similar errors in the future.[28] We intend to follow up to determine if further changes were made by the impacted software providers to provide more necessary guidance to the software users.

25 For a single taxpayer under age 65 at the end of 2014, a return is required if gross income was at least $10,150. IRS Form 1040 Instructions 2014 at 7, Chart A.

26 Detailed observations of the software tests are on file with TAS. Conference call between TAS, ACA Program Office, and W&I CAS to Discuss Free File Test Results (June 18, 2015).

27 *Id.*

28 Email from W&I, CAS to TAS (June 29, 2015).

Taxpayers May Have Received First-Time Penalty Abatement Relief Rather Than Appropriate Penalty Relief Under Notice 2015-9

We applaud the IRS for providing some relief for taxpayers who have balances due on their 2014 returns after reconciling APTC against the PTC allowed on the return. Under Notice 2015-9, the IRS will abate the penalty under IRC § 6651(a)(2) for taxable year 2014 for late payment of a balance due.[29] However, we are concerned some taxpayers may have received penalty relief for late payment under IRC § 6651(a)(2) under the first-time abatement administrative waiver, which is available only once every three years, rather than the relief provided under the Notice.[30] This means some taxpayers who otherwise would qualify for penalty relief during the next three years may not receive it. Our office will investigate this matter to determine the extent to which taxpayers received the inappropriate type of penalty relief, and work with the IRS to reclassify the reason for the penalty abatement.

Lack of Data Caused IRS to Suspend Processing Premium Tax Credit Returns

On February 25, 2015, the IRS alerted employees it needed to match the PTC claimed on returns against third-party data provided by the Department of Health and Human Services. Pending receipt of such data, the IRS suspended the processing of returns it was unable to match. The alert advised employees to tell taxpayers calling about these returns to allow an additional 45 days for processing and review.[31] The IRS updated the alert on March 6, directing employees to tell taxpayers whose refunds have not been issued within 21 days of electronically filing that their returns were under a review that might take an additional 45 days.[32] However, we are concerned the IRS held returns and looked solely to electronic data matching before releasing refunds, ignoring paper documentation that supported the taxpayers' claims, and thereby harming taxpayers.

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 second lowest cost silver plan information. The exchange issued corrected Forms 1095-A. In response, CMS asked taxpayers who (1) received an incorrect Form 1095-A from either the federal or state exchanges and (2) had not yet filed their 2014 tax returns, to wait for corrected forms before filing.[33] Treasury informed taxpayers who had already filed based on the incorrect forms they did not need to file amended returns.[34] Treasury

29 Notice 2015-9, 2015-6 I.R.B. 590 (Feb. 9, 2015).

30 First-time abatement applies if the taxpayer does not have a failure to pay, failure to file, or failure to deposit penalty in the prior three years of the assessment year. For more information on the first-time abatement administrative waiver, see IRM 20.1.1.3.6.1, *First Time Abate (FTA)* (Aug. 5, 2014).

31 IRS, Servicewide Electronic Research Program (SERP) Alert 15A0141, *Returns Reporting a Premium Tax Credit Being Held in Error Resolution System (ERS) Suspense* (Feb. 25, 2015). SAMS Submission 32474 (complaint about delay in processing).

32 SERP Alert 15A0171, *Taxpayer Refund Inquiries with ERS Status Code 249, 349, or 449* (Mar. 6, 2015).

33 CMS, *What Consumers Need to Know About Corrected Form 1095-As* (Feb. 20, 2015) *available at* http://blog.cms.gov/2015/02/20/what-consumers-need-to-know-about-corrected-form-1095-as/.

34 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.

further stated the IRS would not pursue collection of any additional taxes based on the updated information in the corrected forms.[35]

The IRS later advised employees to extend this relief to all taxpayers who received incorrect Forms 1095-A, not just those who had previously filed.[36] 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.[37] However, we remain concerned about the impact the corrected forms had on taxpayers. For example, some may be eligible for a refund but will not amend their returns because they do not understand the meaning of the corrected Form 1095-A, are afraid of being audited, or cannot afford the additional tax return preparation fees involved in amending the return.

Systemic Advocacy Management System ACA Submissions

TAS has received 69 SAMS submissions with ACA issues through June 12, 2015.[38] TAS created an ACA Rapid Response Team to quickly address any significant ACA issues elevated through SAMS or case receipts. In addition to the issues raised above, we received SAMS submissions on the following issues:

- The Vermont state exchange portal was down for approximately two months during open enrollment and the exchange delayed processing change-in-circumstances submissions;[39]
- Unscrupulous preparers improperly calculated the ISRP and instructed the taxpayers to pay the ISRP amounts directly to the preparers;[40]
- Preparers did not properly claim ISRP exemptions for noncitizen taxpayers;[41]
- The preparer altered the return by incorrectly adding PTC without the taxpayer's knowledge and pocketed the incremental amount;[42]

35 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 (TIGTA), Ref. No. 2015-43-043, *Affordable Care Act: Assessment of Internal Revenue Service Preparation for Processing Premium Tax Credit Claims* 12 (May 11, 2015) (TIGTA urges the IRS to develop a tool to enable taxpayers to determine the correct second lowest cost silver plan premium).

36 SERP Alert 15A0147, *Responding to Taxpayer Inquiries about Corrected Forms 1095-A, Health Insurance Marketplace Statements* (Feb. 26, 2015, revised Apr. 6, 2015).

37 Notice 2015-30, 2015-17 I.R.B. 928 (Apr. 27, 2015).

38 SAMS, as of June 12, 2015.

39 The Vermont state exchange was not able to timely process changes in circumstances. Although taxpayers notified the exchange of their change in circumstances in a timely manner, impacted taxpayers had to repay excess advance PTC. The exchange was also not available for a certain period of time during open enrollment. A senator's aide elevated a SAMS recommendation for a new coverage exemption for Vermont residents who were not able to enroll in health care coverage after making attempts during the enrollment period. TAS researched and learned the Vermont Exchange portal was down between September 16 and November 15, 2014. However, residents could still enroll through the phone and paper. SAMS Submissions 32377, 32577, 32647, and 32382.

40 TAS received information from the National Immigration Law Center (see http://www.nilc.org/) and Low Income Taxpayer Clinics (*see* IRC § 7526) that some return preparers are having taxpayers who are not lawfully present, and therefore not responsible for the ISRP, pay the ISRP directly to the preparer. The IRS issued a Tax Tip reminding taxpayers to report unscrupulous return preparers. IRS Health Care Tax Tip 2015-17, *Affordable Care Act Consumer Alert: Choose Your Tax Preparer Wisely* (Mar. 13, 2015). The Tax Tip included a link to Form 14157, Complaint: *Tax Return Preparer.* In addition, the TAS Low Income Taxpayer Clinic Program Office Director issued an alert to the clinics on this topic. SAMS Submissions 32658 and 32612.

41 In some instances, return preparers were adding the ISRP on noncitizen returns instead of properly completing Form 8965, *Health Coverage Exemptions,* to claim a coverage exemption. The IRS issued a Tax Tip stating that taxpayers not lawfully present are exempt from the individual shared responsibility provision and do not need to make a payment. IRS Health Care Tax Tip 2015-17, *Affordable Care Act Consumer Alert: Choose Your Tax Preparer Wisely* (March 13, 2015). SAMS Submission 32658.

42 SAMS Submission 32605.

- An IRS programming issue caused taxpayers' refunds to not properly offset ISRP balances, resulting in the issuance of a refund to the taxpayer and a balance due for the taxpayer for the same tax year;[43]
- The final version of IRS Publication 974, *Premium Tax Credit,* was not available until the end of February;[44] and
- An IRS programming issue caused taxpayers' entire refundable credit to incorrectly offset to a smaller ISRP.[45]

TAS ACA Case Receipts

Through May 31, 2015, TAS received 2,577 ACA case receipts, closed 1,658 ACA cases, and provided relief in almost 78 percent of those cases, with resolution taking an average of about 30 days.[46] Overall:

- Almost 84 percent of the taxpayers who came to TAS with ACA problems were experiencing an economic burden;
- In 91 percent of the ACA cases, the taxpayer was experiencing a problem with the PTC;
- About 48 percent of the PTC cases were related to processing the return in the Submission Processing Error Resolution unit;[47] and
- Almost seven percent of the total ACA case receipts involved a problem with the ISRP.[48]

Most of the taxpayers contacted TAS because their returns and refunds were delayed due to problems with:

- Matching third-party data on returns claiming the PTC;
- The return not including a correct Form 8962, *Premium Tax Credit (PTC),* to reconcile the APTC; or
- Systemic issues offsetting the credit to the ISRP balance.

In the PTC cases, the returns were in the Submission Processing Error Resolution/Reject unit waiting for the IRS to request more information from the taxpayer, or waiting for a response where the IRS asked for

43 TAS received two submissions on this IRS programming issue, identified by the IRS in February, 2015. SAMS Submissions 32672 and 32311.

44 While the IRS referred taxpayers to this publication for help preparing Form 8962, *Premium Tax Credit,* the final version of it was not available until February 27, 2015. As an interim measure, the IRS posted draft worksheets on www.irs.gov prior to the availability of the final Publication 974. SAMS Submissions 32296 and 32147.

45 TAS received several SAMS submissions identifying an IRS programming issue in which the entire amount of refundable credit from taxpayers' individual (Masterfile Tax (MFT) 30) account was offset to the ISRP account, even though the ISRP was much less than the refund. In each case, the taxpayers' refunds were delayed as they were scheduled to offset to the ISRP. Programmers were aware of the problem, scheduled a recovery fix, and the issue was resolved in a week. As the IRS worked to fix this issue, some taxpayers experiencing economic hardships faced additional burdens because of delays in receiving refunds. In addition, even after the fix, holds or freezes were placed on some accounts. SAMS Submissions 32746, 32747, 32761, 32766, 32769, 32773, 32758, 32781, and 32782.

46 Data obtained from Business Performance Management System (BPMS) (run date June 1, 2015).

47 Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (June 17, 2015). TAS uses issue code 315 to identify cases in the Submission Processing Error Resolution unit.

48 Data obtained from BPMS (run date June 1, 2015).

the information before the taxpayer came to TAS.[49] If the Submission Processing unit could not resolve the discrepancy, the IRS continued processing the return but froze the refund to determine whether the return met compliance conditions before releasing all or part of the refund.

Taxpayers reporting an ISRP had their refunds put on hold until the IRS completed an additional review. As a protection, the IRS placed a freeze on the refund without offsetting the ISRP amount to the ISRP account.[50] However, after the IRS completed the review and released the refund, one of two systemic problems occurred:

- A credit did not offset to pay the ISRP balance. This caused taxpayer burden by requiring the taxpayer to repay the ISRP originally reported on the return, instead of the IRS taking the ISRP into account when computing the amount of refund; or
- A programming error caused the entire overpayment to offset to the ISRP balance, thereby creating a credit on the ISRP account. The IRS scheduled a period to recover the credit on the affected accounts. However, because of the potential for a duplicate or erroneous refund, the recovery process prevented TAS from issuing a manual refund to taxpayers experiencing an economic burden.

FOCUS FOR FISCAL YEAR 2016

- Train TAS employees on ACA collection activities, the Employer Shared Responsibility Provision, and provide advocacy tips on working ACA cases;
- Continue to participate on the IRS Joint Implementation Teams and the Executive Steering Committee; and
- Identify systemic issues associated with the ACA, elevate issues to the TAS ACA Rapid Response Team, and work with the IRS to resolve them.

49 When discrepancies and calculation errors existed, or if the taxpayer did not attach Form 8962 to the return, the IRS corresponded with the taxpayer using Letter 12C *(Individual Return Incomplete for Processing: Forms 1040, 1040A or 1040EZ)* to obtain information before continuing to process the return.

50 During original processing of the tax return, the IRS assesses the ISRP amount on the new MFT 35 account and systemically offsets it with an equal amount from the refund shown on the MFT 30 account, if any.

Area of Focus #4 The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers

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*

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's expanded reporting obligations, most of which repeat existing Report of Foreign Bank and Financial Accounts (FBAR) filing requirements.[3] These hardships include additional tax preparation fees and the unwillingness of some foreign financial institutions to do business with U.S. expatriates.[4]

FATCA places substantial day-to-day compliance burdens and costs of implementation on financial institutions. For example, a broad range of U.S.-source payments to a foreign financial institution (FFI) are subject to a 30 percent withholding tax, unless the FFI agrees to provide comprehensive information regarding accounts of U.S. taxpayers.[5] FATCA further charges withholding agents with the responsibility of determining whether they are obliged to undertake FATCA withholding and implementing it when required.[6]

In turn, 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."[7] Although FFIs have some latitude in identifying recalcitrant account holders, customers are in jeopardy of

1 See IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-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). "U.S. taxpayer" is not a specifically defined term within the IRC. But, for purposes of this analysis, it roughly equates to the term "specified United States person" as defined in IRC § 1473(3).

3 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 on the FinCEN Report 114, *Report of Foreign Bank and Financial Accounts* ("FBAR"). *See* 31 U.S.C. § 5314(a). National Taxpayer Advocate 2013 Annual Report to Congress 235.

4 Sofia Yan, *Banks Lock out Americans Over New Tax Law,* CNNMoney (Sept. 15, 2013), *available at* http://money.cnn.com/2013/09/15/news/banks-americans-lockout/; Simon Bradley, *U.S. Expats Feel the Burden of FATCA* (May 28, 2013), *available at* http://www.swissinfo.ch/eng/politics/US_expats_feel_the_burden_of_FATCA.html?cid=35932576; Tom Geoghegan, *Why Are Americans Giving up Their Citizenship?,* BBC News Mag. (Sept. 26, 2013), *available at* http://www.bbc.co.uk/news/magazine-24135021; Katie Holliday, *HSBC Cuts Ties with US Clients Ahead of FATCA*, Investment Week (July 21, 2011), *available at* http://www.investmentweek.co.uk/investment-week/news/2095508/hsbc-cuts-ties-clients-ahead-fatca.

5 IRC § 1471(a); IRC § 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.

6 IRC §§ 1471-1474; Notice 2013-43, 2013-31 I.R.B. 113.

7 IRC § 1471(b)(1)(D)(i).

facing withholding if they do not 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.[8]

When completing a Form W-9, individuals are generally obligated to provide a Social Security number (SSN).[9] TAS has received reports these SSNs are becoming increasingly difficult to obtain for U.S. persons residing abroad who do not already have them.[10] This difficulty, caused in part by a limited number of locations where required interviews for obtaining an SSN can occur, only enhances the burden of FATCA withholding and increases the challenges to obtaining a credit or refund of the withholding in the future.[11]

As part of the 2013 Annual Report to Congress, the National Taxpayer Advocate expressed concerns over the broad sweep of FATCA and the compliance burdens it imposed on individuals and financial institutions.[12] In identifying this issue as a Most Serious Problem, the National Taxpayer Advocate urged the IRS to:

- Gather only the information it would actually use;
- Learn from its experiences with the Offshore Voluntary Disclosure (OVD) programs to more effectively preserve the due process rights of taxpayers; and
- Burden impacted parties as little as possible, consistent with the congressional mandate of FATCA.[13]

The Consequences of FATCA Continue to Fall Heavily on Honest Taxpayers

In her 2013 report, the National Taxpayer Advocate also 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."[14] Further review of updated and expanded data from FY 2010 through the present continues to demonstrate the weight of FATCA is being felt not by tax evaders, but by U.S. taxpayers who likely would be compliant regardless. U.S. taxpayers under the FATCA umbrella who must file Form 8938, *Statement of Foreign Financial Assets*, are generally at least as compliant as the overall U.S. taxpayer population. This comparison is shown in the following table:

8 IRS Form W-9, *Request for Taxpayer Identification Number and Certification* (Dec. 2014); IRS Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)* (Feb. 2014).

9 IRC § 6109(a)(1) requires taxpayers 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 (Treas. Reg. § 301.6109-1(a)(1)(ii)).

10 Patrick W. Martin, *Urgent Need for U.S. Citizens Residing Outside the U.S. to Be Able to Obtain a Taxpayer Identification Number Other Than a Social Security Number,* State Bar of California, Taxation Section, Discussion Paper, meeting with the National Taxpayer Advocate (May 5, 2015). TAS will further explore the severity of this issue during FY 2016.

11 The Social Security regulations require an in-person interview for all applicants age 12 and older (22 C.F.R. § 422.107). The resulting challenges in obtaining a credit or refund of taxes withheld under FATCA exist equally in the case of taxes withheld under Chapter 3 of the IRC, discussed *infra*.

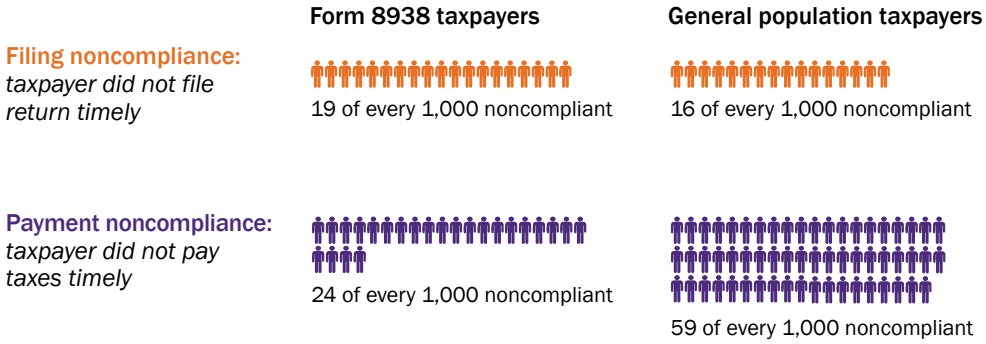
12 See National Taxpayer Advocate 2013 Annual Report to Congress 238-248 (Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act Has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*).

13 *Id.*

14 *Id* at 241.

FIGURE 3.4.1[15]

Noncompliance Rates for Form 8938 Filers vs. General Population Taxpayers



Information reporting can be very useful and influence compliant behavior, provided it is narrowly tailored to accomplish a reasonable result. The National Taxpayer Advocate previously has observed that 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.[16] To this point, the entire population of FATCA filers have not, to TAS's knowledge, shown themselves to be a group in need of special enforcement procedures. Nevertheless, FATCA starts with the unsubstantiated assumption most taxpayers are bad actors and implements a draconian enforcement regime applied to everyone, even to the vast majority of taxpayers who have been, and likely will continue to be, fully compliant.

As a recommendation to help minimize the burden of FATCA compliance for both individual U.S. taxpayers and businesses, the National Taxpayer Advocate proposed the IRS and Treasury adopt a "same-country exception." This regulatory change would exclude from FATCA coverage financial accounts 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 enforcement efforts on identifying and addressing willful attempts at tax evasion

15 Data drawn from IRS Compliance Data Warehouse, Individual Return Transaction File (IRTF) Entity and Individual Master File 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 Discriminant Index Function (DIF) returns in comparison to filers overall. Data drawn April 13, 2015 from IRS Compliance Data Warehouse, 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 Total Positive Income (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 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.

16 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 134.

through foreign accounts.[17] Nevertheless, to this point, the IRS has not been willing to pursue these recommendations proposed by the National Taxpayer Advocate and supported by other stakeholders.[18]

The IRS's Approach to Compliance and Enforcement Is Shifting in Ways That Burden Compliant Non-U.S. Taxpayers

The IRS is developing policies and procedures governing the credit or refund to taxpayers of amounts withheld under FATCA on payments to FFIs or similar institutions (Chapter 4 of the Internal Revenue Code (IRC)). These policies and procedures likewise will apply to amounts withheld on payments of U.S.-source income made directly to non-resident U.S. taxpayers (Chapter 3 of the IRC). As proposed, taxpayers would be entitled to a credit or refund only if they can document that the withholding agent actually deposited the amount withheld with the IRS.[19] Some exceptions to this rule may be available if the amount of the under-deposit of tax is *de minimis*, or if the withholding agent is classified by the IRS as having a demonstrated history of compliance with its deposit requirements. 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.[20]

The IRS argues the shift in enforcement burden now proposed in the international context is necessary as a means of preventing fraud. TAS is unaware of any systematic or rigorous analysis documenting this risk. Moreover, withholding agents, even those active in the international context, are primarily domestic and therefore could be compelled by the IRS to remit the withholding payments they have collected, even where non-resident U.S. taxpayers are involved.[21] The IRS has far more effective tools and comprehensive resources at its disposal for this type of enforcement than the individual taxpayers to whom this burden would otherwise be allocated. As a result, the National Taxpayer Advocate believes non-resident U.S. taxpayers must still have the right to demonstrate their eligibility for a credit or refund by establishing, to the satisfaction of the IRS, the withholding actually occurred. In addition, TAS is concerned about the IRS's position it would only consider a Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, filed by the withholding agent as valid documentation for verifying the tax has been withheld, and that there are very few – if any – circumstances where a taxpayer can provide alternative documentation.[22] TAS will continue advocating, both systemically and through its casework, for the

> Many U.S taxpayers, particularly those living abroad, have incurred increased compliance burdens and costs as a result of FATCA's expanded reporting obligations, most of which repeat existing FBAR filing requirements.

17 A workable same country exception would require the development of detailed guidance from the IRS, ideally arrived at in consultation with FFIs and other stakeholders. One potential starting point would be to allow an FFI to accept the self-reporting of its account holders to the extent that this reliance is reasonable under the facts and circumstances known to the FFI.

18 As stated by representatives of organizations of U.S. citizens abroad, 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. As a result, only accounts in a country other than one's country of residence should be subject to information reporting. TAS meeting 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).

19 Notice 2015-10, 2015-20 I.R.B. 965. Whether, in the view of the IRS, the documentation requirement can be met only by providing a properly issued Form 1042-S, or can be satisfied by furnishing other types of evidence, remains unclear.

20 *See, e.g.,* IRC § 31(a).

21 Notice 2015-10, 2015-20 I.R.B. 965.

22 TAS and LB&I Executives teleconference (May 27, 2015).

IRS to consider alternative documentation provided by taxpayers on a case-by-case basis. The IRS should not treat FATCA as the occasion for fundamentally shifting the risk attributable to the improper actions of withholding agents to non-resident U.S. taxpayers, who are least well-positioned to address and remedy such problems.[23]

Without persuasive explanation or verifiable justification, the IRS's revised focus under FATCA has transformed Chapter 3 and Chapter 4 tax administration into a system that assumes non-compliance 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. In addition to the regulatory changes being contemplated by the IRS, all U.S. taxpayers who file a Form 1040NR requesting a refund of amounts withheld pursuant to FATCA, even those supported by the requisite Form 1042-S, will have the request frozen for up to 168 days, if not longer, while the IRS attempts to match applicable documentation and satisfy itself fraud has not occurred.[24] Thus, thousands of compliant U.S. taxpayers will be denied access to their own funds while the IRS tries to marshal its internal resources and detect a relatively few bad actors. The IRS has made provisions to inform U.S. taxpayers who are experiencing "economic harm" as a result of the refund freeze that they can contact TAS for assistance.[25] Nevertheless, the IRS has not provided TAS with any specific procedures or protocols that can be followed to assist such U.S. taxpayers and release their funds.

FOCUS FOR FISCAL YEAR 2016

- Update and analyze research and stakeholder concerns regarding the impact and effectiveness of FATCA;
- Encourage the development of mechanisms, such as the "same-country exception," to mitigate the unintended negative consequences of FATCA while perpetuating its broader goals;
- Provide recommendations to the IRS and Treasury regarding the policies and procedures that should govern the credits and refunds of amounts withheld under Chapter 3 and Chapter 4;
- Advocate for U.S. taxpayers experiencing significant hardship as a result of systemic Chapter 3 and Chapter 4 refund freezes and issue Taxpayer Assistance Orders (TAOs) as necessary; and
- Work toward the development of a FATCA regime that gathers only the information actually needed by the IRS, burdens impacted parties as little as possible, and preserves the rights espoused by the IRS in the Taxpayer Bill of Rights, including *the right to pay no more than the correct amount of tax* and *the right to privacy.*

23 The burden of the IRS's contemplated approach with respect to Chapter 3 and Chapter 4 would fall particularly hard on non-residents as the IRS has closed its last overseas offices due to budget cuts, making it more difficult for taxpayers not located in the U.S. to resolve their tax issues. David Kocieniewski, *IRS Will Shut Last Overseas Taxpayer-Assistance Centers,* Bloomberg Business (Jan. 14, 2015), *available at* http://www.bloomberg.com/news/articles/2015-01-14/irs-will-shut-last-overseas-taxpayer-assistance-centers.

24 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 15A0188 (Mar. 23, 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). Moreover, as the IRS unilaterally established this systemic refund freeze, taxpayers face the risk that the IRS may seek to extend the refund freeze even further.

25 *Id. See also* IRS SERP Alert 15A0188 (Mar. 23, 2015).

Area of Focus #5 IRS Procedures for Levies on Retirement Plan Assets Create Financial Harm and Undermine Taxpayer Rights

TAXPAYER RIGHTS IMPACTED[1]

- *The right to be informed*
- *The right to challenge the IRS's position and be heard*
- *The right to a fair and just tax system*
- *The right to privacy*

The IRS's Authority to Levy Retirement Accounts Must Be Balanced Against the Strong Public Policy to Protect Individuals' Financial Security in 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 other retirement plans (*e.g.,* Individual Retirement Accounts or defined contribution plans such as 401(k) plans) to make up the shortfall.[3]

Understanding the importance of Americans having sufficient retirement savings, Congress has formulated policies to not only provide Social Security income to retirees, but to protect the rights of individuals to pensions and to encourage retirement savings accounts. For example, the Employee Retirement Income Security Act of 1974 (ERISA)[4] was enacted to provide protection for participants in pension and health plans in private industry. To encourage taxpayers to save money for retirement, Congress has provided a myriad of tax-advantaged retirement savings vehicles.[5] One such retirement plan is the Thrift Savings Plan (TSP), which is available to federal employees and operates much like a 401(k) plan available to many employees in the private sector.

Congress has given the IRS broad powers to collect taxes, including the authority to levy on a taxpayer's property and rights to property.[6] This power to levy extends to assets held in retirement accounts, including the TSP. 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.[7] The

1 See IRS, *Taxpayer Bill of Rights, available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

2 Jack VanDerhei, *"Short" Falls: Who's Most Likely to Come up Short in Retirement, and When?*, Employee Benefits Retirement Institute Notes, 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 June 30, 2015); SSA, *Retirement Planner: Learn About Social Security Programs, available at* http://www.socialsecurity.gov/planners/retire/r&m6.html (last visited June 30, 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 June 30, 2015).

4 Pub. L. No. 93–406, 88 Stat. 829 (1974).

5 For information on what constitutes a qualified retirement plan, see Internal Revenue Code (IRC) § 4974(c).

6 See IRC § 6331.

7 Internal Revenue Manual (IRM) 5.11.6.2(3), *Funds in Pensions or Retirement Plans* (Sept. 26, 2014).

IRS has established three required steps before a Revenue Officer 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 on 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.[8]

As discussed below, IRS guidance as written is not sufficient to protect taxpayer rights. These concerns have been shared with the IRS. However, over the objection of TAS, the IRS has proposed a pilot within its Automated Collection System (ACS) unit, which could automate much of the decision to levy on a TSP retirement account.[9]

IRS Guidance on What Constitutes "Flagrant" Conduct Is Insufficient to Protect Taxpayers' Rights

Generally, the levy on assets held in 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).[10] 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 is only enforceable when the taxpayer is eligible to receive benefits."[11]

IRM procedures that set forth the steps required before IRS can levy a retirement account are not adequately written to provide clear guidance and insufficiently protect taxpayer rights. For example, the IRS must determine if a taxpayer engaged in "flagrant" conduct prior to issuing a levy on a retirement account.[12] The IRM does not define what constitutes flagrant conduct; rather, the IRS must make this determination based on examples in the IRM guidance. IRS employees are instructed to consider extenuating circumstances that mitigate otherwise flagrant behavior and to review each situation on a case-by-case basis, but examples of extenuating circumstances are not included.[13]

One example of flagrant conduct listed in the IRM is the following: "Taxpayers who continue to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed."[14] 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.[15] This is done to encourage

8 IRM 5.11.6.2(4)-(7), *Funds in Pensions or Retirement Plans* (Sept. 26, 2014).

9 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).

10 IRM 5.11.6.2(8), *Funds in Pensions or Retirement Plans* (Sept. 26, 2014).

11 *Id.* 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.

12 IRM 5.11.6.2(5), *Funds in Pensions or Retirement Plans* (Sept. 26, 2014). The guidance points out if a taxpayer has not engaged in flagrant conduct, then the retirement account should not be levied. *Id.* Thus, the determination for flagrant conduct is critical in determining to levy a retirement account.

13 *Id.* The IRM guidance does not include any examples of extenuating circumstances.

14 IRM 5.11.6.2(6), *Funds in Pensions or Retirement Plans* (Sept. 26, 2014).

15 *See* 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).

savings for retirement and to take advantage of employer matching; federal employees must take an affirmative step to stop these automatic contributions.[16] Other employer plans adopt a similar "opt-out" approach to automatically enroll employees.[17] 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.

Nevertheless, the IRM guidance does not require the IRS to educate the taxpayer about the effect of making voluntary contributions or not terminating contributions made through automatic enrollment on the decision to levy a retirement account. Moreover, there is no affirmative requirement that the Revenue Officer ask the taxpayer to stop making contributions prior to levying the retirement account. 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.

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.

Without clear guidance, an IRS employee's assessment of what constitutes flagrant conduct 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 a detailed analysis of the basis for levy, a situation which impacts the taxpayer's *right to privacy*, which provides that taxpayers have the right to expect any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary. Finally, without clear guidance, taxpayers do not know what they need to do to comply with tax laws, which diminishes the *right to be informed*.

The final step in deciding whether a levy on retirement assets is appropriate is to determine if the taxpayer depends on the money in the retirement account for necessary living expenses (or will in the near future).[18] To conduct this analysis, employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to estimate how much can be withdrawn annually from the retirement account while leaving enough for necessary living expenses over the taxpayer's remaining life expectancy.[19]

> **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 divided by 18 years (the years from the taxpayer's retirement age of 62 to 80) 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

16 See 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).

17 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).

18 IRM 5.11.6.2(7), *Funds in Pension or Retirement Plans* (Sept. 26, 2014). Employees are instructed not to levy on the retirement account if it is determined the taxpayer depends on the money in the retirement account (or will in the near future).

19 *Id.* When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

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 corpus 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.

The guidelines for completing the financial analysis are woefully insufficient. For example, there is no requirement to document any minimum retirement age for each type of retirement plan the taxpayer is vested in (*e.g.,* Social Security, IRA, 401(k), TSP). A sound analysis would include simulations comparing scenarios where the taxpayer elects to take distributions at the earliest date allowable with scenarios where the taxpayer elects to take distributions at various other dates to determine the optimal age at which the taxpayer should begin taking distributions from various retirement sources. An impartial and equitable investigation into the numerous options available to the taxpayer for future use and distribution of his or her retirement account would demand a level of education and training that is simply not available to ACS employees. This clearly infringes on taxpayers' *right to a fair and just tax system*. Additionally, 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, there is no provision to ensure 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 build the retirement account back up to a level that provides for a stable retirement.

Furthermore, the proposed plan to levy on the corpus of a retirement plan treats taxpayers disparately, depending on whether they participate in a defined benefit plan (where participants receive a known, fixed amount each month) or a defined contribution plan (where retirement distributions are not fixed, but directly related to the amount of available corpus), such as a TSP. According to the EBRI, retirees are four times more likely to have a defined contribution plan (78 percent) as their primary retirement plan than they would a defined benefit plan (21 percent).[20] If a taxpayer is one of the fortunate few to have a defined benefit plan, the IRS will have no corpus to levy upon at the present time; the IRS can only levy the monthly distributions once a taxpayer reaches retirement age, subject to allowances for basic living expenses, which are calculated based on circumstances at that time. In contrast, the IRS will have the present ability to levy on the corpus of defined contribution plans or IRAs. Recall that the financial analysis required is not sophisticated and is based on conjecture, since it requires the IRS to estimate a taxpayer's necessary living expenses years into the future. Constructing an accurate analysis with so many variables requires a level of financial analysis training ACS employees are not provided.

While the existing IRM guidance is deficient, the procedures written for the pilot provide even fewer protections.[21] For instance, the procedures do not mention extenuating circumstances that could mitigate otherwise flagrant behavior. This type of analysis requires thorough training. The National Taxpayer Advocate is concerned ACS employees participating in the TSP pilot will not receive the necessary training to understand the nuances of a taxpayer's situation, and instead, will use a checklist approach. Procedures for the proposed ACS pilot also water down the ability to determine a taxpayer's reliance on retirement

20 Craig Copeland, *Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data, 2012*, Employee Benefits Retirement Institute Notes, Aug. 2013, *available at* http://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=5256.

21 IRS, *Draft TSP Levy Pilot ACS Procedures* (June 9, 2015).

funds by instructing ACS employees to simply "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."[22]

The ACS pilot may also weaken the requirements for documenting the justification for the decision to levy. Under current guidance, 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 to secure managerial approval.[23] 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.[24] It is unclear how ACS employees will be able to create the necessary memo for managerial review. In fact, the procedures for the proposed ACS pilot do not reference the required memo but do require a manager's signature.[25] 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.

Adoption of the Proposed Pilot Program Would Result in the IRS Treating TSP Participants Disparately from Participants in Other Retirement Plans

As mentioned above, the IRS is in the final stages of approving a pilot program to levy TSP accounts, which ACS employees will administer. More than 115,000 possible TSP account holders (as of the end of 2014) could be impacted if the IRS adopts and expands the pilot program.[26] ACS currently does not levy assets in non-TSP retirement accounts, which means the IRS would be treating one category of retirement plan owners differently from other taxpayers.[27] The IRS has not articulated a reason why it believes levies on federal employees' retirement accounts should receive lesser taxpayer rights protections than levies on non-federal employees' retirement accounts.

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 TSP regulations allow a TSP levy to reach up to the vested account balance.[28] 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.[29] 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.

22 *Id.* ACS employees are instructed to not issue the TSP levy if such documentation is present.

23 IRM 5.11.6.2.1(5), *Thrift Savings Plan* (Dec. 11, 2014). IRM 5.11.1.3.5(2) requires a revenue officer to include certain information in writing when he or she submits a levy for approval. Information includes a summary of information the taxpayer has provided and other collection alternatives considered and rejected.

24 IRM 5.11.1.3.5(6), *Managerial Approval* (Aug. 1, 2014).

25 IRS, *Draft TSP Levy Pilot ACS Procedures* 3 (June 9, 2015).

26 IRS Compliance Data Warehouse, *Accounts Receivable Dollar Inventory for Individuals* (Cycle 201451). Of the 118,507 TSP account holders with delinquent tax accounts, 89,438 had at least one payer Taxpayer Identification Number (TIN) listed on their Form W-2 (box 12) for Tax Year 2013 (61,227 had a single payer TIN). These taxpayers are federal employees, but we have not determined if these employees have TSP accounts. IRS Compliance Data Warehouse, *Accounts Receivable Dollar Inventory for Individuals* and *Information Returns Master File (IRMF) Form W-2 Table.*

27 In an email response to a TAS inquiry, the IRS replied "[w]hile ACS has the authority to issue a levy on retirement accounts, this authority has not been used during the period requested (fiscal years 2014 and 2015)." Email from Senior Advisor to Director, Operations Support, SB/SE (June 23, 2015).

28 5 CFR 1653.35.

29 IRM 5.11.6.2.1(1), *Thrift Savings Plan* (Dec. 11, 2014).

The IRS is administering a legitimate public policy by collecting taxes owed to the federal government, but there must be clear guidance in place to balance the IRS's collection authority against the compelling public policy of encouraging retirement savings and reducing elder poverty, given the harm that can occur with a levied retirement account.

Once the assets in a retirement account are levied upon, they may not be returned in the event of erroneous or wrongful levies.[30] However, as discussed above, the procedures for the TSP levy pilot do not require comparable managerial review of a pre-levy memo prior to approval of the levy.[31] This is just one instance of how a taxpayer in the TSP ACS levy pilot would receive different treatment than a taxpayer working with a Revenue Officer.

ACS employees will not be able to conduct the necessary analysis to make the levy determination because in the ACS unit, cases are assigned to teams, functions, or units rather than individual employees.[32] This is different from the field, where cases are assigned to a specific Revenue Officer. ACS also 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.[33] It is unclear to TAS how ACS will ensure necessary contact with the taxpayer. Last, as discussed above, the National Taxpayer Advocate is concerned ACS will not receive sufficient training and have the skills necessary to conduct the detailed financial analysis required to determine whether the taxpayer will be dependent on the funds in retirement.

The IRS is administering a legitimate public policy by collecting taxes owed to the federal government, but there must be clear guidance in place to balance the IRS's collection authority against the compelling public policy of encouraging retirement savings and reducing elder poverty, given the harm that can occur with a levied retirement account. The National Taxpayer Advocate has highlighted several concerns above to show current guidance is not sufficient to protect taxpayer rights. Before the IRS creates a pilot singling out TSP plans, it must develop detailed guidance that provides analysis particular to each taxpayer's facts and circumstances with respect to all proposed levies on retirement accounts. The current IRM procedures and the proposed ACS pilot undermine both taxpayer rights and retirement security policy.

FOCUS FOR FISCAL YEAR 2016

- Continue to work with the IRS to revise IRM guidance to provide a definition of flagrant, require a full financial analysis, and educate taxpayers about this important collection tool;
- Encourage the IRS to track levies on retirement assets and pay particular attention to levies imposed on TSP accounts;
- Continue to push for abandonment of the TSP levy pilot. If the IRS proceeds with the TSP levy pilot, the National Taxpayer Advocate will accept all ACS TSP levy cases as a criteria nine public policy case if they do not otherwise fit TAS case acceptance criteria; and
- Issue guidance to educate TAS employees on how to advocate for taxpayers facing retirement levies, including the issuance of Taxpayer Assistance Orders when necessary.

30 5 CFR 1653.36(g).

31 As mentioned above, IRM 5.11.1.3.5(6) provides that any notice of levy that requires the approval of the SB/SE Collection Area Director must include a memo explaining the information in IRM 5.11.1.3.5(2), which includes the IRS employee's justification for the levy.

32 IRM 5.19.5.3, *Research on ACS* (Jan. 6, 2015).

33 IRM 5.19.5.4.1(1), *Predictive Dialer Procedures* (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."

Area of Focus #6

As the IRS Migrates to More Self-Service Tools and Online Services, Low Income and Other Vulnerable Taxpayer Populations May Face Greater Compliance Challenges

TAXPAYER RIGHTS IMPACTED[1]

- *The right to quality service*
- *The right to be informed*
- *The right to pay no more than the correct amount of tax*

The IRS has identified online account access as one of the key capabilities to achieve its compliance vision.[2] The National Taxpayer Advocate has been advocating for years that the IRS develop an online account system for taxpayers.[3] However, to provide taxpayer service in an effective and efficient manner, the IRS needs to understand the service needs of its entire taxpayer base. While in the current budget environment it may be tempting to migrate taxpayer service toward superficially lower-cost self-assistance options, any efforts to significantly reduce personal service options (both face-to-face and telephone) 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*.[4]

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.[5] 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 the entire taxpayer population. 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.

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

A recent Forrester Research survey found the public still uses non-digital channels more than digital ones. In fact, survey recipients indicated they do not want more digital interactions with the federal government because they do not trust it with personal data. Based on the survey findings, Forrester concluded federal agencies must act more strategically. They can win trust by perfecting existing digital channels before expanding and explaining the benefits of new channels as they roll out.[6] However, the recent security breaches pertaining to the IRS's "Get Transcript" online application and the Office of Personnel

1 See IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

2 Draft IRS Compliance Concept of Operations (CONOPS) 9-12 (June 25, 2014), on file with TAS.

3 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*).

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

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

6 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).

Management (OPM)'s breach of federal employee records will only serve to undermine taxpayers' trust in communicating with the IRS and government online.[7]

Furthermore, additional research has shown individuals and businesses prefer multi-channel service delivery for government services.[8] Individuals prefer online services for information services, because they can gather and receive information or data 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. As for businesses, the medium to large companies prefer online services more than small businesses.[9]

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. However, a recent survey found demand for live chat falls short of demand for telephone services when addressing complex financial questions.[10]

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

The IRS is understandably eager to expand its online service offerings to meet the public's demand for more convenient methods of interacting with its tax agency. In today's digital age, taxpayers are accustomed to accessing their account information with retailers and financial service providers via the internet or mobile phone applications. With the IRS interacting with well over 100 million individual taxpayers each year,[11] taxpayers would benefit if the IRS could allow taxpayers to:

- Notify the IRS of a change of address;
- Request copies of current and prior year Forms W-2 and Forms 1099;
- Request copies of prior year returns processed by the IRS;
- View the status of recently filed returns;
- View the current balance due, broken out by taxes, penalties, and interest;
- Make payments on a balance due;
- Make estimated payments; and
- Upload documents in response to IRS requests.

The IRS has made some strides in improving the taxpayers' online experience. For example, the IRS2Go application allows mobile phone users to check their refund status by inputting their Social Security number (SSN), filing status, and refund amount. The IRS's "Get Transcript" web application (now

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

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

9 Julia Klier, Regina Pfleger, and Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, AIS Electronic Library, Wirtschaftsinformatik Proceedings 2015 at 190 (2015).

10 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).

11 *See* IRS, IR-2015-03, *IRS Starts 2015 Tax Season; Free File Opens Tomorrow, E-File Tuesday; Expanded Online Services Enable People to Learn About New Health Care Provisions* (Jan. 15, 2015), *available at* http://www.irs.gov/uac/Newsroom/IRS-Starts-2015-Tax-Season;-Free-File-Opens-Tomorrow,-EFile-Tuesday.

temporarily suspended until further notice) allowed taxpayers the ability to request transcripts of their prior filed returns, after answering some questions to validate their identity.[12]

However, we must be realistic in assessing the risk involved in expanding online services, given the sensitive nature of the information entrusted with the IRS. Security breaches exposing customer data are a regular occurrence; the recent unauthorized access by cybercriminals of the IRS's "Get Transcript" application and resulting theft of the confidential tax return information of approximately 104,000 taxpayers drives home this point.[13] OPM's recent announcement that its database has been hacked, making vulnerable the personal information of an estimated 18 million current or former federal employees, has further undermined public trust.[14]

In the wake of these recent cybersecurity breaches, the IRS should take time to investigate how much risk the public is willing to bear with respect to their tax information. It is one thing for hackers to access, for example, credit card numbers from a retailer, and it is quite another for them to have unfettered access to a taxpayer's SSN, full name, address, wage information, filing status, and dependents – in other words, everything an identity thief would need to file a falsified return posing as the taxpayer. Taxpayers should understand the IRS has a greater responsibility with respect to cybersecurity than, for example, an airline or even a credit card company.[15] Therefore, the IRS must conduct due diligence to balance security concerns with any purported online benefits, simply because the stakes are so high. It also should not impose a digital strategy on taxpayers that erodes taxpayers' trust for the IRS's own convenience.

However, to provide taxpayer service in an effective and efficient manner, the IRS needs to understand the service needs of its entire taxpayer base.

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,[16] 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,

12 IRS, *IRS Statement on the "Get Transcript" Application* (June 2, 2015).

13 *See* http://www.irs.gov/uac/Newsroom/IRS-Statement-on-the-Get-Transcript-Application. *See also* Lisa Rein and Jonnelle Marte, *Hackers Stole Personal Information from 104,000 Taxpayers, IRS Says*, Wash. Post, May 26, 2015.

14 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.

15 *See* Jonnelle Marte, *A Year of Credit Monitoring Won't Put Risk to Rest*, Wash. Post, May 30, 2015.

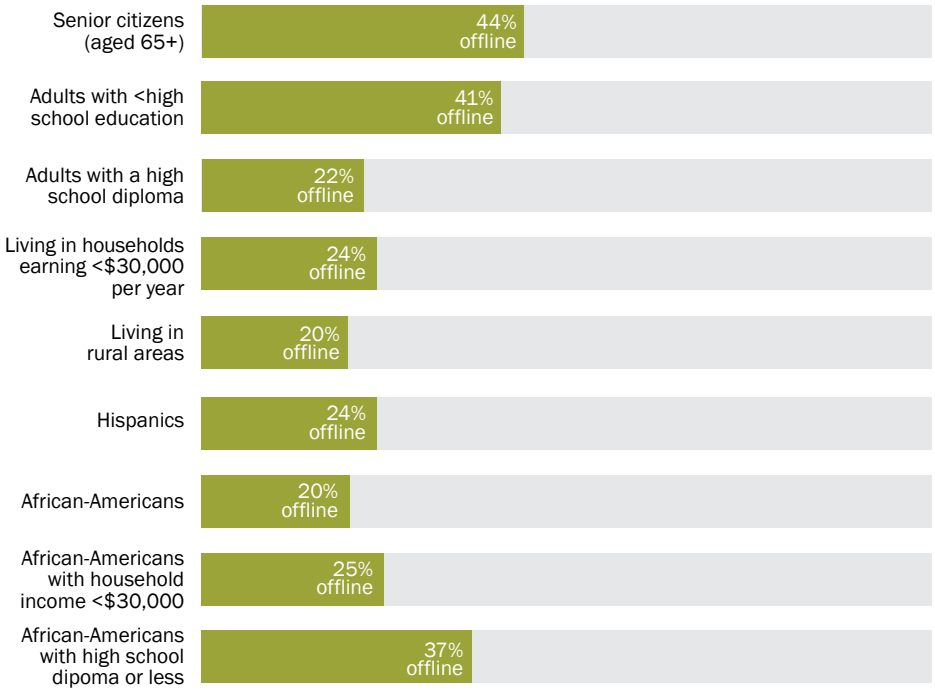
16 The IRS awards matching grants to organizations that provide representation to low income individuals who need help resolving tax problems with the IRS. *See* IRC § 7526. At least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the federal poverty 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).

24 percent contacted their preparers, and nearly 20 percent did nothing (the survey allowed more than one response).[17]

Further, Pew Research Center conducted several surveys to determine the percentage of adult individuals who are offline (not using the internet or email). The following figure shows the categories of individuals found by the surveys to have the highest *offline* rates in 2013.[18]

FIGURE 3.6.1

2013 Pew Research Center Survey Results of Adults Who Are Offline



17 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*).

18 Pew Research Center's Internet & American Life Project, *Who's Not Online and Why?* (Sept. 2013) (phone survey conducted in 2013); *see also* Pew Research Center, *Older Adults and Technology Use: Adoption Is Increasing, But Many Seniors Remain Isolated from Digital Life* (Apr. 2014) (phone survey conducted in 2013); Pew Research Center's Internet Project July 18 to September 30 Tracking Survey, *African Americans and Technology Use: A Demographic Portrait* (Jan. 2014).

Finally, a 2014 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:[19]

- 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 four percent when using a mobile phone;
- With very few exceptions, those in lower income brackets used all devices to conduct online financial transactions less frequently than the national average; and
- On average, 21 percent of adults use their mobile phones to check financial statements. Only 13 percent use their mobile phones to pay bills or transfer money between accounts.

The LITC-eligible taxpayer survey and Pew and Forrester findings 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 short-term resource savings. The survey findings show a significant portion of taxpayers may not use online or self-assistance services. While online self-help tools may address the needs of many taxpayers 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.

Questions Remain Concerning the Legal Implications of Self-Correction Authority

According to the IRS draft Compliance 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.[20] We remain concerned about the scope of this self-correction authority. For example, it is unclear whether the self-corrections could address adjustments made pursuant to the agency's math error authority.[21] 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.[22] It is unclear if the IRS will give preparers and third parties the authority to address these correctable errors.[23] The National Taxpayer Advocate will seek a Counsel opinion to determine the boundaries and corresponding legal implications of such authority.

19 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 2 (2014), on file with TAS.

20 Draft IRS Compliance CONOPS 3, 19-22 (June 2014), on file with TAS.

21 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.

22 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.

23 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).

We are also concerned about which preparers and third parties will have self-correction authority. As discussed below, there seem to be no current restrictions on access by type of tax practitioner. Therefore, it appears the IRS has no plans to limit the online account access or associated self-correction authority of unregulated preparers who are not subject to IRS oversight pursuant to Circular 230.

Only Circular 230 Preparers Should Have Access to an Online Taxpayer Account System

In the draft CONOPS, the IRS has proposed to provide preparers with access to the taxpayer's online account.[24] Accordingly, the National Taxpayer Advocate has the following concerns related to a preparer's role when accessing a taxpayer's online account:

- How will the taxpayer designate a preparer authorized to gain online account access?;
- How will the taxpayer maintain control over the extent of authority granted to the preparer?;
- Will the IRS safeguard confidential taxpayer return information by implementing strict security requirements on preparer access?;
- What is the scope of the preparer's authority to correct errors through online account access?; and
- How will the IRS ensure that the preparer has not exceeded the authority granted by the taxpayer?

The National Taxpayer Advocate is concerned the IRS will expose taxpayers to potential harm due to incompetence or misconduct if it does not restrict access to those preparers regulated by the IRS under Circular 230.[25] Because we know there are preparers who are committing refund fraud,[26] and we know certain payroll service providers who have access to employer accounts also embezzle funds and change account information to hide this, there is a risk the IRS will create significant compliance problems unless it institutes safeguards.[27]

In addition, the LITC-eligible taxpayer survey findings, discussed above, raise fundamental questions about the appropriateness of relying on preparers (as distinguished from representatives) as intermediaries for the low income population, especially the Spanish speakers in this category, and particularly with respect to the unregulated return preparer population. Pursuant to the survey, a majority of all LITC-eligible taxpayers reported using return preparers, as did approximately 75 percent of Spanish-speaking eligible taxpayers. However, a significant percentage of these preparers did not satisfy the very basic

24 Draft IRS Compliance CONOPS 3, 19-22 (June 2014), on file with TAS.

25 31 C.F.R. Part 10.

26 *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. 18-20 (2015) (written testimony of Nina E. Olson, National Taxpayer Advocate). *See also* National Taxpayer Advocate 2014 Annual Report to Congress 543-44; National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-8; 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*).

27 *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. 20-3 (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*).

statutory requirements under IRC § 6695(a) and (b).[28] Participants reported, for example, the preparer either 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.[29] Accordingly, TAS will advocate that only return preparers within the scope of Circular 230 should have access to a taxpayer's online account.[30]

While online self-help tools may address the needs of many taxpayers 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.

FOCUS FOR FISCAL YEAR 2016

- Continue to advocate for low income taxpayers and other vulnerable populations who have significant offline rates by working with the IRS to ensure it maintains meaningful and high-quality service options for these populations;
- Work with the IRS to ensure it incorporates strict security safeguards on preparer access to taxpayer online accounts;
- Work with the IRS to restrict preparer access to taxpayers' online accounts to those preparers who are regulated by Circular 230; and
- Seek a Counsel opinion to determine the boundaries and corresponding legal implications of the self-correction authority provided to preparers.

28 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.

29 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*).

30 Rev. Proc. 2014-42 provides that preparers who have obtained the voluntary record of completion as part of the Annual Filing Season Program are allowed to represent taxpayers before the IRS during an examination of a tax return or claim for refund they prepared. Unenrolled preparers without the voluntary record of completion will no longer be allowed to engage in limited practice on returns they prepare after December 31, 2015. Further, to receive the record of completion, the preparer must consent to be subject to the duties and restrictions relating to practice before the IRS in subpart B and section 10.51 of Circular 230 for the entire period covered by the record of completion.

Area of Focus #7 Additional Requirements for Appeals Access and Compressed Case Timelines Impair the Fundamental Rights of Taxpayers

TAXPAYER RIGHTS IMPACTED[1]

- *The right to appeal an IRS decision in an independent forum*
- *The right to a fair and just tax system*
- *The right to pay no more than the correct amount of tax*

The IRS Office of 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."[2] 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.[3] For example, under AJAC, whenever taxpayers raise new issues or present additional evidence requiring further investigation, Appeals generally will send cases back to the Compliance function (Compliance) for development and evaluation.[4]

Unfortunately, Compliance has used AJAC to adopt a more stringent policy with respect to Information Document Requests (IDRs) and to close cases and bypass Appeals unless a taxpayer provides all requested documentation or certifies no additional information is available.[5] For example, Letter 5262 was 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."[6]

While the IRS agreed to discontinue the use of this letter after the National Taxpayer Advocate brought it to the attention of senior leadership, the creation of any additional obstacles or absolute prohibitions

1 See IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

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

3 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, "of, relating to, or involving an executive or administrative official's adjudicative acts." Black's Law Dictionary (9th ed. 2009). 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.

4 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.

5 TAS is primarily aware of this practice arising within the SB/SE Examination function. TAS Elevated Issue Conference with SB/SE (July 30, 2014).

6 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). Note: The referenced Statutory Notice of Deficiency (SNOD) would allow the taxpayer 90 days to appeal the IRS determination to the U.S. Tax Court.

to an appeal within the IRS under the guise of AJAC has many troubling aspects.[7] As a threshold matter, 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, either in whole or in part. Moreover, a telephone call from a taxpayer confirming 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.[8] 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, the same taxpayer will be barred from exercising that right.

When TAS objected to this policy, Compliance initially replied it expected mistakes would be made and the approach was subject to a learning curve, but the policy was consistent with AJAC.[9] Fundamental appeal rights should not be so easily, and possibly inadvertently, forfeited by taxpayers and arbitrarily overridden by the IRS.[10]

Access to Appeals is crucial for several reasons. For example, Appeals considers evidence Compliance generally does not take into account. Among other things, Appeals will accept affidavits and weigh oral testimony. Further, Appeals, unlike Compliance, has the ability to settle cases based on the hazards of litigation.[11] Appeals will also seek to negotiate a case resolution with the taxpayer based on the existing factual record even if those facts are incomplete or not thoroughly documented. This policy, clarified by Appeals as part of AJAC, is contradicted and undercut by the approach Compliance now follows. For many taxpayers, the Compliance policy could prevent their cases from ever even reaching Appeals before the IRS automatically issues a SNOD.[12]

Another important settlement tool possessed by Appeals but not available in Compliance is application of the *Cohan* rule.[13] *Cohan*, which originally developed via judicial case law, allows the fact finder to estimate deductible expenses where the fact of those expenses, although not their amount, can be substantiated.[14] The *Cohan* rule, along with other settlement vehicles employed by Appeals, is an integral aspect

7 This agreement would need to be implemented by a revision to IRM 4.10.8.11, *Eligibility for Appeals Conference and Preliminary Letters (SB/SE Field and Office Examiners only)* (Sept. 12, 2014). In the meantime, SB/SE issued a June 9, 2015 memorandum temporarily suspending the use of 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 of Examination's use of Letter 950, *30 Day Letter - Straight Deficiency.* The memorandum addresses only those cases still open in SB/SE and does not contemplate any relief for taxpayers whose cases were closed using these suspended letters. TAS urges SB/SE to make this suspension permanent, to revise the policies that led to the issuance of these letters, and to work with TAS, Appeals, and others within the IRS to develop relief measures for taxpayers who have been denied access to Appeals through the policies embodied in these letters.

8 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 taxpayers may possess the information but may have objections to the scope, relevance, or legality of some of the information sought by the IDR.

9 TAS Elevated Issue Conference with SB/SE (July 30, 2014).

10 Such cases generally can be returned to Appeals by the U.S. Tax Court after a petition is filed in response to the SNOD. Nevertheless, this indirect approach ignores the unnecessary administrative burdens and overall stress to which taxpayers are subjected and the additional costs incurred by both taxpayers and the government.

11 IRM 8.6.2.5.4.2, *Resolved Based on Hazards of Litigation* (Oct. 18, 2007).

12 IRM 8.6.1.6.2 (2), *General Guidelines* (Nov. 14, 2013).

13 *See Cohan v. Comm'r,* 39 F.2d 540 (2d Cir. 1930).

14 The *Cohan* rule cannot be used in situations where IRC § 274(d) applies. Section 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deductions are allowable for certain travel, entertainment, and other specified expenses.

of the voluntary compliance system and cannot be abridged without impairing the fundamental equity and effectiveness of that system.

Compliance's approach, which is wrong in principle, is made worse in practice by the compressed timelines it needlessly imposes on taxpayers before issuing the SNOD. In the typical SB/SE field examination, taxpayers receive an initial letter that includes an information request. In the event taxpayers do not respond within ten days, they are sent a second letter in the 5262 series demanding all requested information and threatening the loss of appeal rights if they do not provide the information or inform the IRS it is unavailable. If the 15-day period also elapses, or if the IRS is unsatisfied with the taxpayer's response, the SNOD is issued and Appeals is bypassed. As noted above, this practice was recently suspended, but it should be permanently revised so as to avoid confusion in the short run and resumption in the long run.

TAS has received comments from some tax practitioners who believed 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.[15] In a recent op-ed piece from the *New York Times*, a tax practitioner observed that if the compressed time frames are 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."[16] 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,* which recently have been acknowledged and adopted by the IRS, mean little if the IRS implements policies impairing those rights.[17]

In some situations AJAC is being used as an instrument for limiting taxpayers' access to Appeals or coercing them into taking steps not in their best interests.

Further, according to some practitioners, Compliance has been using AJAC as a tool for "bullying" taxpayers in other circumstances.[18] TAS has received some reports that Compliance, under the vague but broad cloak of AJAC, has aggressively been demanding taxpayers sign waivers of the statute of limitations on assessment, extending it for one to two years. These demands have been made 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 statute of limitations for the case to be transferred to Appeals.[19] 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."[20] However, in some situations AJAC is being used as an instrument for limiting taxpayers' access to Appeals or coercing them into taking steps not in their best interests.

15 TAS conference call with Low Income Tax Clinics 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.

16 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.

17 *See* IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

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

19 *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).

20 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).

FOCUS FOR FISCAL YEAR 2016

- Provide guidance to TAS employees on how to advocate for taxpayers whenever AJAC is used to impair, rather than perpetuate, taxpayer rights;
- Issue Taxpayer Assistance Orders, where appropriate, to protect taxpayers' right to appeal;
- Educate internal and external stakeholders regarding the impact on taxpayers of AJAC implementation by Compliance and Appeals; and
- Advocate with the IRS to revise AJAC-related policies whenever those policies impose burdens on taxpayers and limit their rights.

Area of Focus #8 The IRS Approves Many Applications for Tax-Exempt Status Almost Automatically, Often Based on Insufficient Information

TAXPAYER RIGHTS IMPACTED[1]

- *The right to be informed*
- *The right to finality*

Taxpayers seeking exempt status as IRC § 501(c)(3) organizations have applied for recognition using IRS Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code,* for over 30 years.[2] Revisions to the form have made it more comprehensive (it is now 12 pages long, not counting required schedules or attachments, compared to nine pages in 1998).[3] Because "[f]or many if not most small [exempt organizations], one or two pages of questions that elicit basic information would suffice," the National Taxpayer Advocate recommended the Tax Exempt and Government Entities division (TE/GE) design a Form 1023-EZ smaller organizations could use.[4] The IRS has now adopted a shorter form, but the form has gone too far in the opposite direction by "eliciting" only a series of check-marks in boxes. As discussed in last year's Objectives Report, in July 2014, the IRS adopted Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, over the objections of the National Taxpayer Advocate and various stakeholder groups.[5] Because Form 1023-EZ does not require applicants to provide supporting documentation or substantiation, but only to attest they qualify for exempt status, the IRS has in effect relinquished its power to educate and regulate taxpayers before it confers exempt status.

TE/GE recognizes its new approach carries compliance risks, which it intends to address by auditing organizations it already recognized as exempt.[6] While audits are certainly a legitimate method of ascertaining whether an organization is or continues to be exempt, the National Taxpayer Advocate believes helping taxpayers meet the requirements for exempt status from inception, prior to granting recognition of exempt status, is the most effective approach for increasing cost effectiveness, reducing taxpayer burden, and enhancing consumer protection.

1 See IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

2 *See, e.g.,* Office of Information and Regulatory Affairs, Office of Management and Budget, Information Collection Request Ref. No. 198104-1545-056, approving a 1981 revision of the form.

3 *See, e.g.,* Jack Siegel, *Re-Engineering Form 1023 to Identify Problem Organizations Before Exemption Is Granted: Watch out for the "Penalties of Perjury" Statement* (Nov. 3, 2004), commending the IRS for "attempting to identify those organizations that are likely to violate the rules governing Section 501(c)(3) organizations before granting tax-exempt status rather than relying on an audit process that is currently underfunded and spotty."

4 National Taxpayer Advocate 2011 Annual Report to Congress 448 (Status Update: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*). Noting that Form 1023 requires the applicant to "[l]ist the names, titles, and mailing addresses of each of your five highest compensated employees who receive or will receive compensation of more than $50,000 per year," for example, the National Taxpayer Advocate suggested a Form 1023-EZ that simply asks if any employees receive more than $50,000 per year in compensation from the organization. If so, the EO could be required to file the full Form 1023. *Id.,* n. 44.

5 *See* National Taxpayer Advocate Fiscal Year (FY) 2015 Objectives Report to Congress 54-57.

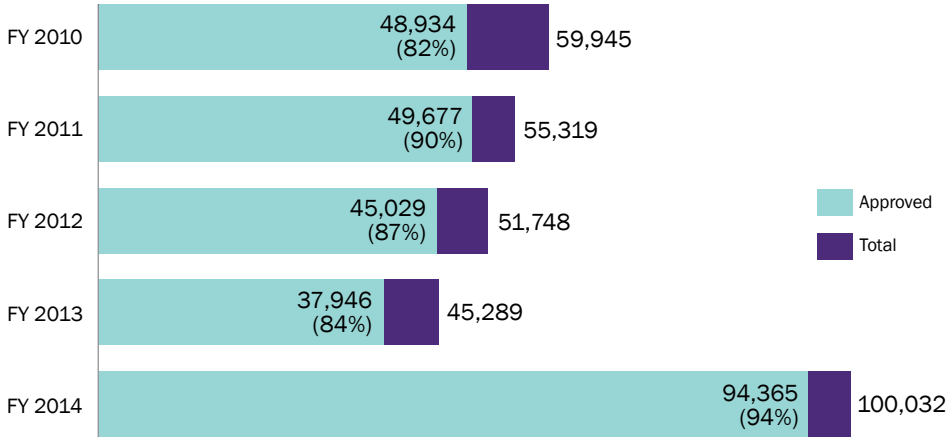
6 *See, e.g.,* TE/GE Business Performance Review (BPR) First Qtr. 2015 Appendix B, TE/GE Risk Register (Feb. 2015) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2015/TEGE%20BPR%201st%20Quarter%20FY%202015.pdf, noting that "[p]erceived inadequate oversight 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."

In 2014, the Volume of IRS Exempt Status Determinations As Well As the Approval Rate Increased

Figure 3.8.1 shows the number of determinations and approval rates TE/GE's Exempt Organizations (EO) function made each year on applications for exempt status under IRC § 501(c)(3) from FYs 2010 through 2014. Between 82 and 94 percent of IRC § 501(c)(3) applications received approval during this period. From 2010 through 2013, the IRS made determinations for fewer than 60,000 applications each year. The IRS doubled the number of 1023 determinations it made in a year from FY 2013 to 2014.

FIGURE 3.8.1[7]

Determinations of Exempt Status as Section 501(c)(3) Organizations



In January and February of 2014, EO adopted streamlined procedures for processing applications from organizations seeking section 501(c)(3) exemptions.[8] The procedures allowed certain aspects of the application to be "developed through attestation" (*i.e.,* by relying on the applicant's affirmation) rather than on the basis of substantiating documents.[9] In July 2014, the IRS introduced Form 1023-EZ, available to certain organizations with annual gross receipts of $50,000 or less, which consists entirely of attestations. As EO worked through its backlog of cases using these procedures, the number of determinations of exempt status under section 501(c)(3) rose to 100,000 in 2014, and the rate of approval increased to 94 percent.[10]

7 Table 24, *Closures of Applications for Tax-Exempt Status, by Organization Type and Internal Revenue Code Section,* IRS Data Books, 2010-2014.

8 *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) and TEGE-07-0214-02, *Streamlined Processing Guidelines for All Cases* (Feb. 28, 2014).

9 On Dec. 9, 2013, EO provided TAS with a detailed description of the streamlined process. See SAMS Submission 28975.

10 *See, e.g.,* TE/GE BPR, Fourth Qtr. 2014 at 16-17 (Nov. 2014) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2014/TEGE%20BPR%204th%20Quarter%20FY%202014.pdf, noting, "At the end of FY 2014 [Sept. 30, 2014], we have a total of 22,759 cases in open inventory, which is a 65 percent decrease from the end of FY 2013. We worked each case more efficiently due to the implementation of streamlined processing."

The information on the e-Postcard [Form 990-N] is insufficient to allow a potential donor or researcher to determine whether the organization actually conducts exempt activities. Thus, Form 1023-EZ and Form 990-N, even taken together, provide almost no transparency.

Since the launch of Form 1023-EZ, the approval rate for applications submitted on this form alone has been 95 percent.[11] More than half (51 percent) of all applications for recognition as a section 501(c)(3) organization are now submitted on Form 1023-EZ.[12] The annual reporting requirement of organizations recognized as exempt on the basis of Form 1023-EZ is generally Form 990-N (e-Postcard), an electronic submission that provides only eight pieces of information.[13] The information on the e-Postcard is insufficient to allow a potential donor or researcher to determine whether the organization actually conducts exempt activities. Thus, Form 1023-EZ and Form 990-N, even taken together, provide almost no transparency.

TE/GE's Analysis of a Random Sample of Form 1023-EZ Applicants Demonstrates EO Erroneously Grants Exempt Status

In response to concerns raised by the National Taxpayer Advocate, TE/GE agreed as it introduced Form 1023-EZ, it would require additional documentation from a representative sample of applicants and would review the information before making a determination.[14] The purpose of this pre-determination review would be "[t]o address the concern that information collected would be insufficient to make a correct determination."[15] The method would be "to take a statistical sampling of the [Form 1023-EZ] applications and put them through the more rigorous process, to see if they've answered the questions correctly, or whether they've, in fact, if they'd gone through the 26-page questionnaire [Form 1023], would have been not qualified, whereas that looks like they're qualified."[16] Over the first six months after the release of Form 1023-EZ, TE/GE selected 521 organizations for pre-determination review as part of a representative sample, and by February 2015, had made determinations in 411 cases.[17] As part of the review, EO employees rejected applications from

11 *See* TE/GE BPR Second Qtr 2015 at 5 (May 2015), First Qtr. 2015 at 2 (Feb. 2015), and Fourth Qtr. 2014 at 2 (Nov. 2014), all reporting approval rates of 95 percent for Form 1023-EZ applications.

12 TE/GE BPR Second Qtr. 2015 at 5 (May 2015) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2015/TEGE%20BPR%202nd%20Quarter%20FY%202015.pdf, noting that for the second quarter of FY 2015, Form 1023-EZ applications constituted 51 percent of total applications for recognition as section 501(c)(3) organizations.

13 Form 990-N, which may be filed by organizations with annual gross receipts of normally $50,000 or less, requires the organization's employer identification number (EIN); the tax year; the organization's legal name and mailing address; any other names the organization uses; the name and address of a principal officer; the website address if the organization has one; confirmation the organization's annual gross receipts are $50,000 or less; and if applicable, a statement the organization has terminated or is terminating (going out of business). IRS, *Information Needed to File E-Postcard*, *available at* http://www.irs.gov/Charities-&-Non-Profits/Information-Needed-to-File-e-Postcard. Because an e-Postcard does not contain sufficient data to calculate tax liability or determine tax-exempt status, and does not purport to be a return, "the filing of a complete Form 990 or Form 990–EZ, rather than the submission of an annual electronic notification, is the filing of a return that starts the period of limitations for assessment under section 6501(g)(2)." Treas. Reg. § 1.6033-6(c)(4). *See also* T.D. 9366, 2007-52 I.R.B. 1232, 1233.

14 *See* National Taxpayer Advocate FY 2015 Objectives Report to Congress 56, urging TE/GE to evaluate a representative sample of organizations whose applications had been approved pursuant to EO's streamlined procedures to determine whether those organizations were actually compliant. *See also* Rev. Proc. 2014-40, 2014-30 I.R.B. 229, sec. 5.03, providing that "the Service will select a statistically valid random sample of Forms 1023-EZ for pre-determination reviews."

15 TE/GE, *Form 1023-EZ Six-Month Pulse Check* 6, presented to and discussed with the National Taxpayer Advocate on April 21, 2015.

16 William Hoffman, *An Interview With IRS Commissioner John Koskinen,* 2014 TNT 147-2 (July 29, 2014).

17 TE/GE, *Form 1023-EZ Six-Month Pulse Check* 5, presented to and discussed with the National Taxpayer Advocate on April 21, 2015. Additional organizations are selected for pre-determination review over time and added to the representative sample. By March 31, 2015, the total number of organizations selected for pre-determination review was 844, and while the number of rejected applications was reported, as discussed below, TE/GE was not able to identify the total number of cases for which a determination had been made. TE/GE BPR Second Qtr. 2015 at 34 (May 2015) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2015/TEGE%20BPR%202nd%20Quarter%20FY%202015.pdf.

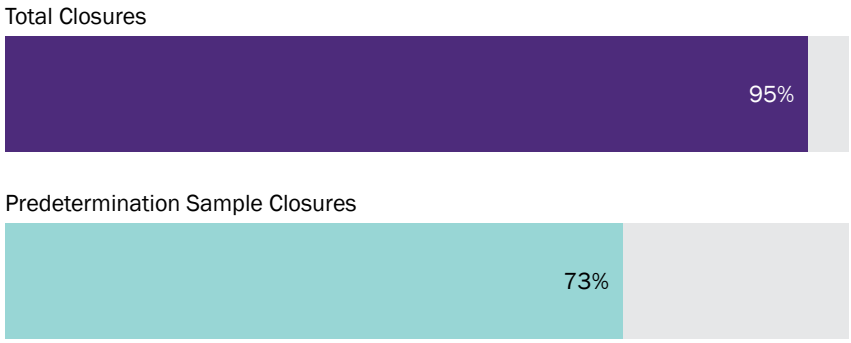
applicants ineligible to file a Form 1023-EZ and those that had not used a valid EIN in the application.[18] EO agents requested additional information from remaining applicants, to be submitted under penalties of perjury, including "the organizing document with language required to meet the organizational test; a detailed description of past, present, and future activities; revenues and expenses; and a detailed description of any transactions with donors or related entities."[19] If the responses were not forthcoming, EO rejected the applications.[20]

As Figure 3.8.2 shows, out of 411 organizations in the sample for which a determination had been made, 301 were recognized as section 501(c)(3) organizations.[21] This approval rate – 73 percent – is far lower than the 95 percent rate for Form 1023-EZ filers generally.[22] As noted, out of the 521 applications in the sample, 110 had not yet been closed by the time TE/GE reported the partial results of its pre-determination review. Even if EO ultimately approves all remaining sample cases, however, the approval rate would only be 79 percent.[23]

Because Form 1023-EZ does not require applicants to provide supporting documentation or substantiation, but only to attest they qualify for exempt status, the IRS has in effect relinquished its power to educate and regulate taxpayers before it confers exempt status.

FIGURE 3.8.2[24]

Form 1023-EZ Approval Rates (through Dec. 26, 2014)



18 Of the closed sample cases, 28 percent were ineligible to submit Form 1023-EZ, usually because actual or projected gross receipts exceeded $50,000. TE/GE, *Form 1023-EZ Six-Month Pulse Check* 5, presented to and discussed with the National Taxpayer Advocate on April 21, 2015.

19 TE/GE, *Form 1023-EZ Six-Month Pulse Check* 4, presented to and discussed with the National Taxpayer Advocate on April 21, 2015.

20 Rejected Form 1023-EZ applications are not final determinations for purposes of the declaratory judgment provisions of IRC § 7428. Rev. Proc. 2014-40, sec. 6, 2014-30 I.R.B. 229, 234 (July 21, 2014).

21 TE/GE's pre-determination procedures provide "[a]n organization's application can be approved, rejected, or denied. An organization's application for exempt status is denied if the IRS determines that the organization does not meet the organizational or the operational test." *TE/GE, Form 1023-EZ Six-Month Pulse Check* 2, n. 1, presented to and discussed with the National Taxpayer Advocate on April 21, 2015.

22 Moreover, as Figure 3.8.2 shows, the overall approval rate for Form 1023 applications from FY 2011-2014 ranged from 82 to 94 percent.

23 With the remaining 110 approvals, total approvals would be 411 of 521, or 78.9 percent.

24 Based on data reported in TE/GE, *Form 1023-EZ Six-Month Pulse Check*, Tables 2 and 4, presented to and discussed with the National Taxpayer Advocate on April 21, 2015.

In other words, by adopting Form 1023-EZ, EO approved section 501(c)(3) applications it would have rejected had the applications been subject to the slightest scrutiny. Because the cases selected for pre-determination review were part of a representative sample, the findings of the review can be projected to the entire population of Form 1023-EZ applications.[25] TE/GE reported through the second quarter of FY 2015, it closed 30,601 Form 1023-EZ applications, approving 29,069, or 95 percent, of them.[26] Based on the findings of the pre-determination review showing the approval rate for Form 1023-EZ applications subjected to more scrutiny was only 73 percent, we expect only 22,411 of the 30,601 Form 1023-EZ applications should have been approved. The discrepancy between the number of Form 1023-EZ applications that were approved (29,069) and the expected number that should have been approved (22,411) was 6,658, representing an error rate of more than 21 percent.[27]

As noted above, by March 31, 2015, there were 844 cases in EO's representative sample of organizations selected for pre-determination review.[28] TE/GE was not able to specify the number of reviews that have been completed, but reported EO rejected 150 applications in the sample.[29] Of the 150 applications EO rejected, one of the most frequent reasons for rejection was the applicant was ineligible to file a Form 1023-EZ. The instructions to Form 1023-EZ and the accompanying Eligibility Worksheet identify certain organizations as ineligible to use Form 1023-EZ even though they may qualify for exempt status.[30] These organizations must apply for exempt status using Form 1023 instead. Form 1023-EZ applicants attest they have completed the Eligibility Worksheet and are eligible to submit Form 1023-EZ. Nevertheless, at least 41 percent of the rejected applications were from organizations ineligible to use Form 1023-EZ. The main reasons for their ineligibility were:

- Gross receipts were expected to exceed $50,000 in any of the next three years (21 percent of the rejections were for this reason);
- The application was submitted more than 15 months after automatic revocation by an organization seeking retroactive reinstatement (11 percent of the rejections were for this reason); and
- Annual gross receipts exceeded $50,000 in any of the past three years (nine percent of the rejections were for this reason).[31]

Had additional questions not been asked of these organizations, EO would have granted them exempt status despite the demonstrably incorrect attestations and even though TE/GE has determined that as a rule, applications from organizations in that class should receive greater scrutiny. Consumer and taxpayer protections would have simply been bypassed in these cases, as they presumably were in other applications that did not receive the additional scrutiny.

25 TE/GE's description of its pre-determination review does not include the level of confidence associated with the sample findings or the margin of error, but the number of applications in the sample suggest a level of confidence of 95 percent and a five percent margin of error.

26 TE/GE BPR Second Qtr. 2015 at 34 (May 2015) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2015/TEGE%20BPR%202nd%20Quarter%20FY%202015.pdf.

27 6,658 is 21.8 percent of 30,601.

28 TE/GE BPR Second Qtr. 2015 at 34 (May 2015) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2015/TEGE%20BPR%202nd%20Quarter%20FY%202015.pdf.

29 TE/GE response to TAS information request (June 11, 2015); TE/GE BPR Second Qtr. 2015 at 34-36 (May 2015) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2015/TEGE%20BPR%202nd%20Quarter%20FY%202015.pdf.

30 Eligibility requirements are also set out in Rev. Proc. 2014-40, sec. 2, 2014-30 I.R.B. 229.

31 Some applicants were ineligible for other reasons, but the frequency of rejection for another reason *(e.g.,* because the applicant was a credit counseling organization, or had $250,000 in assets) was usually less than one percent and comprised less than five percent of rejections overall.

Failure to respond to EO's request for further information by the due date represented 41 percent of rejections, or more than 60 organizations. Lack of response from organizations does not inspire confidence they have sufficient infrastructure to operate a tax-exempt organization subsidized by all U.S. taxpayers.[32]

Anecdotal Evidence Supports the Conclusion EO Erroneously Recognizes Organizations as Tax-Exempt

TAS recently selected for review 13 corporations that:

- Obtained recognition as section 501(c)(3) organizations in March 2015 on the basis of a Form 1023-EZ; and
- Are located in states in which corporations' articles of incorporation are available for online inspection free of charge.[33]

The states from which the organizations were selected were Alaska (five organizations), Colorado (four organizations), and Ohio (four organizations). TAS reviewed each organization's articles of incorporation to determine whether they contained an adequate purpose clause and dissolution clause sufficient to meet the organizational test described in the regulations under section 501(c)(3).[34] In some states, sometimes referred to as *cy pres* states, an organization can also meet the dissolution provision requirement if, by operation of state law or court action, its assets would be distributed for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose, even though a specific dissolution provision is not contained in its creating document.[35] Ohio is one such state.[36]

TAS found:

- Only three of the 13 organizations met the organizational test for section 501(c)(3) organizations;[37]
- The inadequacy of the purpose clause alone precludes tax-exempt status as a section 501(c)(3) organization in eight cases;
- The lack or inadequacy of a required dissolution clause alone precludes tax-exempt status as a section 501(c)(3) organization in six cases; and

32 To its credit, EO attempted to contact these unresponsive organizations, and the rate of rejections due to unresponsiveness has decreased. From Jan. 24-Mar. 27, 2015, only six applications were rejected on this basis. TE/GE BPR Second Qtr. 2015 at 35-36 (May 2015) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2015/TEGE%20BPR%202nd%20Quarter%20FY%202015.pdf.

33 Many (more than 20), but not all, states make corporations' articles of incorporation viewable online free of charge. EO is investigating whether it could obtain, free of charge, electronic access to all state articles of incorporation. TE/GE BPR, Third Qtr. 2014 at 4 (Aug. 2014) *available at* https://organization.ds.irsnet.gov/sites/tege-cl/Strategic%20Planning/BPRs/FY2014/TEGE%20BPR%203rd%20Quarter%20FY%202014.pdf.

34 The organizing document must limit the purposes of the organizations to one or more exempt purposes; not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes; and must permanently dedicate the organization's assets to section 501(c)(3) purposes on dissolution. Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4).

35 See Treas. Reg. § 1.501(c)(3)-1(b)(4). *Cy pres* is "[t]he equitable doctrine under which a court reforms a written instrument with a gift to charity as closely to the donor's intention as possible, so that the gift does not fail." Black's Law Dictionary (9th ed. 2009).

36 Rev. Proc. 82-2, 1982-1 C.B. 367.

37 TAS did not inquire into the operations of any of the 13 organizations. The three organizations that met the organizational test did not necessarily meet the operational test, also required for tax-exempt status as section 501(c)(3) organizations. See Treas. Reg. § 1.501(c)(3)-1(c)(1), providing that "[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)." If an organization fails either the organizational test or the operational test, it is not exempt. Treas. Reg. § 1.501(c)(3)–1(a)(1).

- In five cases, organizations had neither an adequate purpose clause nor an adequate dissolution clause.

Figure 3.8.3 below summarizes the findings of the review of 13 cases.

TABLE 3.8.3, Findings of the Review of 13 Cases

Finding	Cases
Purpose Clause and Dissolution Clause (if required) Both Sufficient	3
Purpose Clause Sufficient, But Required Dissolution Clause Insufficient	1
Purpose Clause Insufficient, But Dissolution Clause Not Required (or if required, Sufficient)	3 (all in *cy pres* state)
Both Purpose Clause and Dissolution Clause (if required) Insufficient	5
Not Found on State Website	1
Total	**13**

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- Analyze the articles of incorporation of a representative sample of corporations that obtained exempt status on the basis of Form 1023-EZ from July 1, 2014, when Form 1023-EZ was introduced, through March 31, 2015. To the extent the analysis demonstrates Form 1023-EZ is an insufficient basis on which to make a determination whether an organization qualifies as a section 501(c)(3) organization, TAS will recommend corrective changes to Form 1023-EZ; and
- Review the procedures TE/GE develops for its post-determination audits of exempt organizations, recommending changes as appropriate, and reviewing the outcome of the audits.

Area of Focus #9 International Local Taxpayer Advocates Would Provide Valuable Assistance to Taxpayers and Protect Their Rights

TAXPAYER RIGHTS IMPACTED[1]

- *The right to be informed*
- *The right to quality service*
- *The right to a fair and just tax system*

The IRS has significantly decreased its overseas taxpayer service presence in recent years, reducing the number of tax attaché posts in foreign cities from 15 to four, while increasing the number of locations and employees devoted to criminal investigations.[2] Despite the growth in the international taxpayer population, the IRS plans to eliminate all IRS tax attaché posts abroad by the end of calendar year 2015, citing the multi-year decrease in funding.[3]

The closing of these offices is part of a broader shift away from providing basic in-person taxpayer service and relieving procedural burdens facing international taxpayers.[4] Given the overwhelming complexity of international tax rules and reporting requirements and the potentially devastating penalties for even inadvertent noncompliance, the IRS's focus on enforcement with inadequate service may lead some voluntarily compliant taxpayers to give up and become noncompliant, and may ultimately increase the international tax gap.[5]

Taxpayers abroad, many of whom may have tried to follow the rules and comply with the tax laws, have little recourse when they face problems. The Internal Revenue Code (IRC) provides for the establishment of the Office of the Taxpayer Advocate, which assists taxpayers in resolving problems with the IRS, identifies areas in which taxpayers have problems in their dealings with the IRS, and proposes administrative and legislative changes to mitigate these problems.[6] When taxpayers abroad face barriers to receiving assistance from TAS, their *right to a fair and just tax system* is impaired. Currently, there are no Local Taxpayer Advocates (LTAs) outside the United States and its territories. The IRC requires the National Taxpayer Advocate to "monitor the coverage and geographic allocation of local offices of taxpayer

1 Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-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. Since the 1980s, the IRS has steadily reduced its civil tax presence overseas to save on security, construction, and maintenance costs. The IRS maintains ten Special Agent attachés in Bogota, Columbia; Mexico City, Mexico; London, England; Frankfurt, Germany; Ottawa, Canada; Hong Kong, China; Bridgetown, Barbados; Beijing, China; Panama City, Panama; and Sydney, Australia. IRS intranet, Criminal Investigations, International Operations, *available at* http://ci.web.irs.gov/sections/operations/international.htm.

3 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 will close 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).

4 Since 2009 the IRS has also suspended overseas assistance tours at U.S. embassies because these tours were not cost-effective and "minimal in relation to the number of taxpayers living abroad." During the last overseas assistance tour from February 28 to March 31, 2008, IRS employees provided face-to-face assistance to 2,603 individuals at 21 U.S. embassies, spending approximately four days at each location. In 2007, W&I assisted 2,090 individuals at 25 locations. W&I responses to TAS research request (Oct. 14 and 19, 2009).

5 See Area of Focus: *IRS Implementation of FATCA is Burdensome and Fails to Protect the Rights of Affected Taxpayers, supra.*

6 IRC § 7803(c).

advocates."[7] While the IRC specifically requires the National Taxpayer Advocate to appoint LTAs and make at least one available for each state,[8] it does not include a similar requirement for LTAs outside the country; however, there is no prohibition to establishing such offices. Establishing LTAs abroad would provide international taxpayers with better access to TAS, increase communication, and encourage future compliance. It would also assist TAS in identifying emerging and ongoing systemic issues. As such, TAS will continue to advocate not only for the reopening of the IRS tax attaché offices abroad, but also for an LTA to be co-located at each of these sites.[9]

TAS Serves a Wide Variety of International Taxpayers with Various Issues

In fiscal year (FY) 2014, TAS received approximately 2,330 cases from taxpayers with international addresses[10] from approximately 90 different countries.

Over half of TAS's overseas cases in FY 2014 came from a handful of countries, with the pattern continuing in FY 2015.[11] The data suggest TAS has key opportunities for placing LTAs in countries where large groups of U.S. taxpayers frequently face difficulty in dealing with the IRS. Figure 9.1.1 on the following page illustrates this point.

7 IRC § 7803(c)(2)(C)(i).

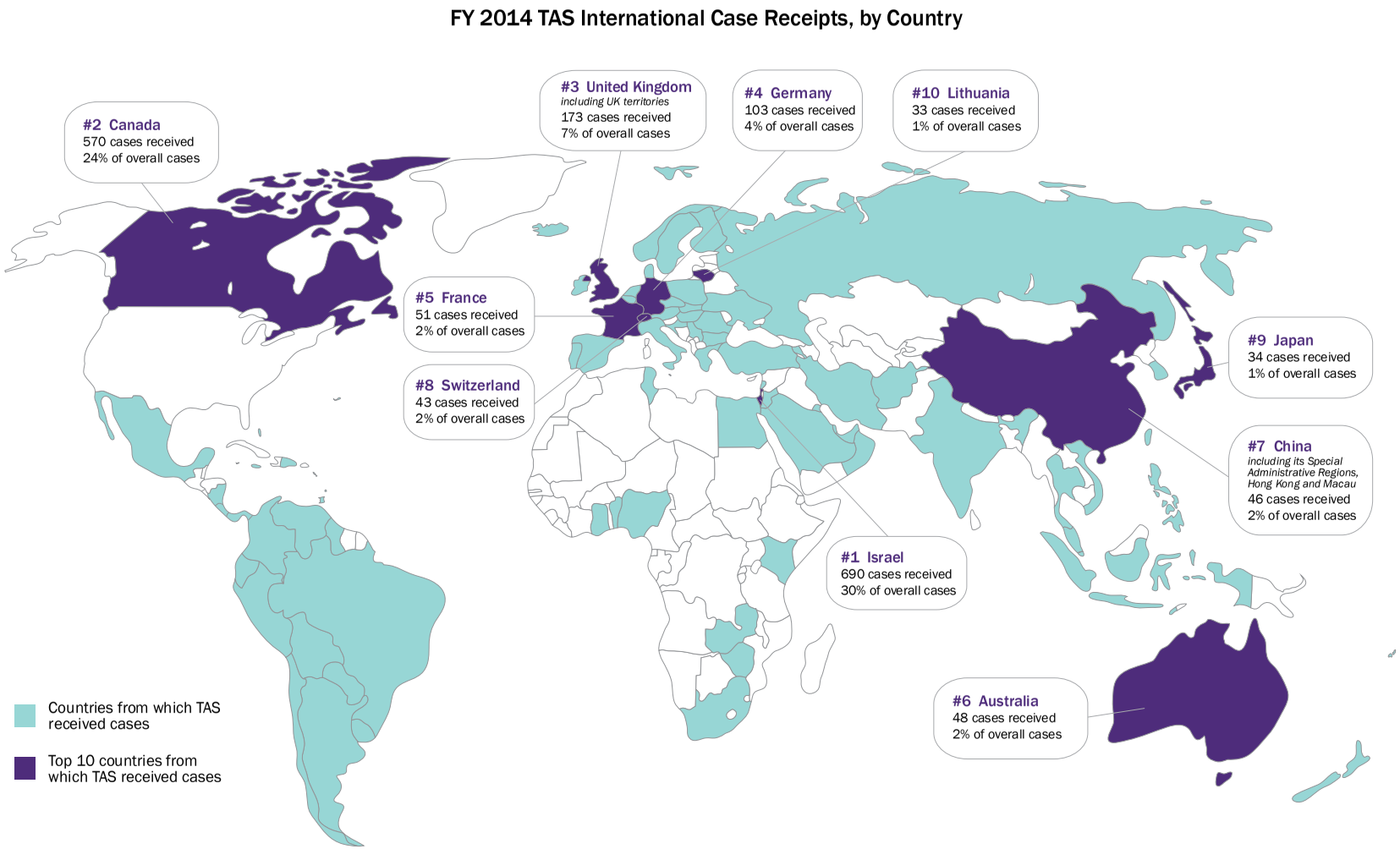
8 IRC § 7803(c)(2)(D)(i)(I).

9 *See Internal Revenue Service FY 2016 Budget Request, Hearing Before the S. Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations,* 114th Cong. (2015) (testimony of Nina E. Olson, National Taxpayer Advocate).

10 Taxpayers with addresses from U.S. territories outside the continental United States are included in this number. Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Mar. 2015).

11 FY 2015 data runs through February 28, 2015.

FIGURE 9.1.1[12]



12 Countries were determined by the address the taxpayer used in filling out TAS paperwork.

TAS cases from taxpayers abroad included a variety of issues, but the most frequent issues are similar to those experienced by taxpayers in the United States.[13] The top five issues in FY 2014 from taxpayers with international addresses were:

1. Accounts Management Taxpayer Assurance Program – Pre-Refund Wage Verification Holds;[14]
2. Open Audit;
3. Form W-7/Individual Taxpayer Identification Number/Adoption Taxpayer Identification Number;[15]
4. Refund inquiries not included as a separate issue code; and
5. Processing of an original individual or business return.

While these issues are not unique to international taxpayers, their residence overseas may play a significant role in these cases. For example, a taxpayer undergoing an audit could have difficulty proving a deduction if the IRS examiner refused to accept international documentation due to a lack of familiarity with it. Thus, some of these cases may include a uniquely international angle even when they share the same issue category as domestic cases.

Lack of LTAs Abroad May Deter Taxpayers from Contacting TAS

Of the cases received in FY 2014 from taxpayers abroad, roughly 40 percent resulted from the taxpayer or the taxpayer's representative filing Form 911, *Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order)*, or other correspondence. Approximately 27 percent of the cases stemmed from the IRS identifying a case as meeting TAS criteria and referring it to TAS. It is unclear how many more taxpayers might have contacted TAS if they could have done so through an LTA abroad, who would be able to conduct outreach and inform international taxpayers about the availability of TAS assistance. Taxpayers may have been discouraged from contacting TAS due to barriers such as time zone differences, lack of access to toll-free phone lines, and time delays in mailed correspondence. Even a limited TAS presence abroad might aid communication because some phone services offer free calls from one country to another in Europe. Because taxpayers living abroad face such significant barriers in accessing the IRS and TAS and communicating with them in a timely and efficient way, they are not receiving the quality of service they need. Thus, taxpayers' *right to quality service* is being weakened.

TAS Needs a Physical Presence Abroad to Keep Abreast of Systemic Issues Facing International Taxpayers and Provide Relief to These Taxpayers

All taxpayers who are suffering or about to suffer a significant hardship, including those abroad, should be able to get assistance from TAS on individual cases or on systemic issues facing multiple taxpayers. Without international LTA offices, TAS is limited in its ability to identify trends affecting groups of international taxpayers and understand their unique needs and concerns. Although almost half of TAS's

13 Data obtained from TAMIS (Mar. 2015).

14 The Accounts Management Taxpayer Assurance Program was replaced with the Integrity and Verification Operation, which is responsible for pre-refund fraud detection, revenue protection, and associated account resolution activities. See IRM 25.25.1.1, *Overview* (Oct. 1, 2014).

15 Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Aug. 2013) is the application for an Individual Taxpayer Identification Number (ITIN), which is required for a person with a tax return filing requirement who is not eligible for a Social Security number. Adoption Taxpayer Identification Numbers (ATINs) are temporary identification numbers assigned by the IRS to children who have been placed by an authorized placement agency in the household of a prospective adoptive parent for legal adoption. These are required to claim certain tax benefits for the child who does not have a Social Security number. See IRM 3.13.40.1, *Adoption Taxpayer Identification Number (ATIN) - Overview* (Jan. 1, 2015).

cases from abroad in FY 2014 were opened because the taxpayer experienced a delay of more than 30 days in resolving an account problem, approximately one-third were due to a systemic or procedural failure.[16] This suggests the need for LTA offices to be located strategically outside the United States to gain knowledge and awareness of the problems that groups of taxpayers are facing in different geographic areas and to be able to assist them.

Although domestic TAS offices would work most cases received by LTAs abroad, the LTAs abroad would play a key role in integrating case advocacy and systemic advocacy. A hypothetical example involves a scenario where a large number of residents from one country visit an LTA to seek help with problems involving national identification documents used for an ITIN application. If an LTA were embedded in that country or region, he or she would be in a better position to understand the local issues and advocate for changes to IRS procedures. Another example, which was reported on TAS's Systemic Advocacy Management System (SAMS),[17] involves European taxpayers who frequently use open-source software. These taxpayers cannot electronically file Foreign Bank and Financial Accounts (FBAR) forms because the format is not compatible with their software. An LTA based in Europe who understands the characteristics of the population, such as the use of different software, would be in a better position to identify issues like this upfront and advocate proactively.

> Taxpayers abroad, many of whom may have tried to follow the rules and comply with the tax laws, have little recourse when they face problems.

TAS LTAs Abroad Could Provide Valuable, Targeted Outreach and Communication

In addition to taking in cases, interfacing with taxpayers, and supporting systemic advocacy, LTAs play a vital role in outreach and communication. No matter where they live, taxpayers should be able to find out what they need to do to comply with the tax laws. LTAs educate taxpayers by providing targeted outreach to their communities. As in previous years, in FY 2015, LTAs were tasked with identifying at least one unique or significant issue in their communities, while still understanding and addressing the other community issues, and incorporating it into their outreach.[18]

LTAs also work with local organizations to provide grassroots outreach and communication. The LTA in Philadelphia, Pennsylvania developed a productive partnership with the city's Mexican consulate and a Low Income Taxpayer Clinic that aids farmworkers. During monthly outreach events at the consulate, which provides services to all Mexican citizens in Pennsylvania and New Jersey, the partners offer information about TAS services, identity theft, return preparer fraud, tax credits, ITINs, and other issues. While this partnership was effective in helping a small group of international taxpayers located specifically in two U.S. states, it was limited to taxpayers in that geographic area. If there were LTAs abroad, they could engage in similar partnerships to specifically address the needs of a particular taxpaying population in the country or region where the LTA would be located. TAS would have the opportunity to create similar partnerships abroad with U.S. embassies and other offices that provide services to U.S. taxpayers.

16 Data obtained from TAMIS (Mar. 2015).

17 SAMS is a web-based database of issues and information used by IRS employees and the public to report systemic issues and problems to TAS. For more information, see http://www.irs.gov/sams.

18 See TAS FY 2015 Program Letter, Appendix 4.

International LTAs Would Provide Valuable Services with Minimal Staffing

For FYs 2016 and 2017, TAS submitted budget requests to place an international LTA and Intake Advocate, who would provide administrative support, in each of the four international tax attaché offices. While only requiring eight additional staff, these four offices could have a great impact on international taxpayers, with opportunities to:

- Obtain information to correctly file taxes, both in the United States and with foreign taxing agencies;
- Claim appropriate exemptions and deductions;
- Receive answers to taxpayer questions that arise from tax treaties among multiple governments;
- Provide assistance to taxpayers dealing with foreign governments, laws, tax treaties, and income taxes;
- Advocate for taxpayers dealing with the tax laws of foreign governments; and
- Allow for collaboration with other IRS employees as well as the embassy and consulate staff and representatives from foreign taxing agencies.

Under TAS's proposal, international LTAs would collaborate with other IRS employees as well as the embassy and consulate staff and representatives from foreign taxing agencies. The Advocates would provide a voice for taxpayers through advocacy outreach to officials in those agencies where taxpayers currently have no representation.

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- Identify a list of the most significant issues facing international taxpayers based on case advocacy and systemic advocacy data, and create targeted outreach materials for these issues;
- Identify ten U.S. embassies abroad in locations where a large number of U.S. taxpayers face problems with the IRS and conduct outreach with these offices by correspondence, sharing international outreach materials and the TAS Tax Toolkit;
- Create a team to research and draft a written report identifying financial, logistical, security-related, and other issues related to establishing LTAs abroad;
- Review case advocacy data and SAMS submissions to identify specific locations abroad where TAS could place LTAs to maximize their effectiveness;
- Continue to monitor systemic issues and identify additional training needs for Case Advocates on international issues; and
- Continue to advocate for reopening the IRS tax attaché offices abroad with the addition of an LTA at each site.

Area of Focus #10 TAS Continues to Work with IRS to Implement the Taxpayer Bill of Rights into IRS Operations

TAXPAYER RIGHTS IMPACTED[1]

- *The right to be informed*
- *The right to a fair and just tax system*

Both the Internal Revenue Code (IRC) and IRS administrative procedures provide taxpayers with many rights when dealing with the IRS. However, taxpayers may not exercise these rights, and IRS employees may not honor them – in both cases because they are unaware of them.[2] The National Taxpayer Advocate has repeatedly recommended that Congress enact a comprehensive Taxpayer Bill of Rights (TBOR) to capture and organize all the rights in the IRC into a single place.[3] Similarly, the National Taxpayer Advocate recommended the IRS adopt a TBOR to serve as an organizing principle for tax administrators, an educational framework for IRS employees, and a tool to empower taxpayers. To its credit, in 2014, the IRS adopted the TBOR that pulls together in one basic statement the principles that underlay the substantive rights scattered throughout the IRC and provided by administrative procedures.

In 2013, when the National Taxpayer Advocate urged the IRS to adopt the TBOR, she wrote a report to the Acting Commissioner, outlining recommendations to increase awareness of taxpayer rights for IRS employees and taxpayers.[4] TAS has acted on a number of the key recommendations in that report to make the TBOR "real." One of these steps was to audit the Internal Revenue Manual (IRM) to find appropriate places to insert taxpayer rights information. The IRM is the "primary, official source of IRS 'instructions to staff' that relate to the administration and operation of the Service."[5] As such, it is a major vehicle for educating IRS employees about:

- The importance of taxpayer rights overall;
- How they apply with respect to specific IRS procedures and actions; and
- When and how to inform taxpayers about their rights.

When these instructions are unclear or incomplete, or do not explain *why* an action is important from a taxpayer rights perspective, employees may misinterpret them, take shortcuts, skip steps, and thus act in ways that undermine taxpayer rights or fail to act in ways that promote taxpayer rights.

1 See IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

2 For more information regarding awareness of taxpayer rights, see National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf.

3 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 275-310 (Legislative Recommendation: *Codify the Taxpayer Bill of Rights and Enact Legislation That Provides Specific Taxpayer Protections*).

4 See National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf. The National Taxpayer Advocate also issued a report to the Acting Commissioner in August 2013 on ways to increase awareness of taxpayer rights and TAS. *National Taxpayer Advocate's Report in Response to the Acting Commissioner's 30 Day Report: Analysis and Recommendations to Raise Taxpayer and Employee Awareness of the Taxpayer Advocate Service and Taxpayer Rights* (Aug. 19, 2013), *available at* http://www.taxpayeradvocate.irs.gov//userfiles/file/2013FullReport/30-Day-Report.pdf.

5 IRM 1.11.2.2, *IRM Standards* (May 11, 2012).

When [Internal Revenue Manual] instructions are unclear or incomplete, or do not explain *why* an action is important from a taxpayer rights perspective, employees may misinterpret them, take shortcuts, skip steps, and thus act in ways that undermine taxpayer rights or fail to act in ways that promote taxpayer rights.

TAS has made significant progress on its audit. In last year's Objectives Report to Congress, the National Taxpayer Advocate reported that the TBOR IRM review team had identified an initial group of about 570 high-impact subsections in IRM 4, *Examining Process*; IRM 5, *Collecting Process*; and IRM 21, *Customer Account Services*.[6] At the time of last year's report, the team had reviewed about 425 of the approximately 570 high-impact subsections, and developed over 140 recommendations, of which TAS sent 36 to the IRS. TAS has continued its review of the IRM, including sections that come to TAS as part of the normal clearance process, as well as high-impact sections reviewed outside the clearance process.[7] As of March 2015, TAS has sent 87 IRM recommendations related to TBOR, of which the IRS has accepted 50.[8]

Some of TAS's TBOR recommendations would add information to the IRM about the specific rights that apply in a situation. For example, the original text of Accounts Management IRM 21.3.4.12.5.8, *Levy Release: General Information for Field Assistance*, explains:

> Field Assistance does not issue levies. They are normally issued by collection employees after the taxpayer has been given an opportunity to resolve their tax liability but failed to do so. Taxpayers will generally come into the TAC [Taxpayer Assistance Center] once they learn that a Notice of Levy has been issued and are requesting a release.

TAS recommended the IRS add the following sentence to the end of this paragraph, which it has agreed to consider in the next update: "TAC employees should be aware of Collection Appeal rights and be able to provide taxpayers with information regarding these rights, as outlined in Publication 1, *Your Rights as a Taxpayer*." This sentence not only reminds employees about a taxpayer's *right to appeal an IRS decision in an independent forum*, it also reinforces the importance of being able to explain the right to taxpayers who are seeking a levy release.

TAS also recommended an addition to the second paragraph of this IRM section, which originally explained a levy release "is not required for a levy that was issued prior to reaching a resolution with the taxpayer unless it meets one of the criteria for required release located in IRM 5.19.4.4.10, *Levy Release: General Information*." TAS recommended the following note:

> Note: Taxpayers have the right to expect a fair and just tax system which considers facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers also have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial hardship or if an issue has not been resolved through normal IRS procedures in a timely manner.

This addition would reinforce the fundamental principle of a fair and just tax system and explains in plain language what this right means.

6 See National Taxpayer Advocate FY 2015 Objectives Report to Congress 12-21.

7 IRMs require TAS review and clearance when the rights or duties of taxpayers are impacted or taxpayers are affected in some way. For a discussion of the clearance process, see IRM 1.11.9.1.1, *IMD Clearance Process* (Dec. 4, 2014).

8 The 87 IRM recommendations include the 36 sent over as of last year's report.

In addition to providing instructions to employees regarding specific rights that apply, some IRM recommendations involved increasing awareness of the TBOR generally. For IRM 22.24.1.1.1, which provides the IRS mission statement in IRM Part 22, *Taxpayer Education Assistance*, the IRS accepted TAS's recommendation to add the following note:

> The IRS formally adopted a Taxpayer Bill of Rights in June 2014, which provides the nation's taxpayers with a better understanding of their rights and helps reinforce the fairness of the tax system. IRS employees must be informed about taxpayer rights and be conscientious in the performance of their duties to honor, respect and effectively communicate those rights which may aid in reducing taxpayer burden. See Publication 1, *Your Rights As A Taxpayer*, for more information.

TAS is updating its own IRM to include TBOR information in IRM 13.1.1, *Taxpayer Advocate Legislative History, Mission, and Guiding Principles*. In addition, TAS has begun the process of drafting a policy statement to be included in IRM Part 1.2, *Servicewide Policies and Authorities*, which would reaffirm the IRS's commitment to the TBOR. TAS communicated its plan regarding the policy statement to the Office of Servicewide Policy, Directives, and Electronic Research (SPDER), which in turn expressed support for adding a TBOR Policy Statement to the IRM.

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- Continue reviewing IRM sections and making recommendations for adding taxpayer rights information;
- Provide training to all TAS employees reviewing IRMs on how to incorporate the TBOR into the IRM, and through SPDER, make that training available to all IRS employees who are authors or reviewers of IRMs;
- Update IRM 13.1.1 to include TBOR information; and
- Draft a TBOR Policy Statement and submit it to the IRS to be included in IRM Part 1.2.

Area of Focus #11 The IRS Must Have a Comprehensive Review Process for Guidance and Other Documents to Protect Taxpayer Rights, Improve Customer Service, and Operate More Efficiently

TAXPAYER RIGHTS IMPACTED[1]

- *The right to quality service*
- *The right to be informed*

An often overlooked, but critical, role of TAS is to review IRS guidance, notices, forms, publications, letters, and similar items prior to their release. IRS employees depend on accurate, up-to-date instructions to perform their duties and use the proper procedures. Similarly, taxpayers depend on guidance and publications from the IRS to help them understand their obligations and how to fulfill them. When the IRS updates its guidance or other documents, the authors must seek out and secure input from various reviewers (*e.g.,* TAS and Chief Counsel). This review – known as the Internal Management Documents/Single Point of Contact (IMD/SPOC) process – provides TAS with an opportunity to impact IRS policies prior to implementation, which benefits the IRS and taxpayers since the published instructions and guidance are essential to fulfillment of the taxpayer's *right to be informed*.[2] However, the IRS recently adopted a fragmented clearance approach that limits TAS's ability to provide comments and suggestions, minimize taxpayer burden, and protect taxpayer rights.[3]

To advocate effectively, TAS must have an opportunity to timely review IMDs and other documents. TAS receives letters from the Office of Taxpayer Correspondence (OTC) with as few as five business days to review. When TAS only has the opportunity late in the process to identify changes necessary for the protection of taxpayer rights, document owners have publishing deadlines to meet and are less inclined to discuss changes with TAS. In one instance, TAS input was largely ignored. By working with TAS from the beginning of the review process, IRS could put taxpayers first, improving the efficiency of its reviews, saving resources, and minimizing taxpayer burden.

An example of including TAS proactively involves the Tax Exempt/Government Entities (TE/GE) division, which revised its IRM guidance on how to update taxpayer letters. The guidance initially directed employees to gather suggestions from TAS after the revised letter was ready for publication. TAS recommended TE/GE change its guidance to include TAS earlier in the review process. TE/GE adopted the change and will now include TAS *before* it sends letters to the OTC, which is the last office to handle the document before publication.[4] TAS now has an opportunity to advocate for taxpayers and negotiate any differences of opinion before TE/GE publishes the letters. TAS applauds TE/GE's common sense approach, and encourages other areas of the IRS to adopt these practices.

1 *See* IRS, Taxpayer Bill of Rights, *available at* http://www.irs.gov/Taxpayer-Bill-of-Rights.

2 For a full list of taxpayer rights, see http://www.irs.gov/Taxpayer-Bill-of-Rights. Additionally, for a full list and discussion of the ten core taxpayer rights, see National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration (Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights)* (Nov. 4, 2013), *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf.

3 *See* Internal Revenue Manual (IRM) 1.11.9.7(3), *Guidelines for Reviewers* (Dec. 4, 2014). During the clearance process, the IRS has restricted reviewers' comments. The reviewers are only allowed to comment on content that was revised by the author.

4 *See* TEGE-25-0215-0004 (IGM 25.1) *Interim Guidance for TE/GE Letter and Notice Procedures* (Feb. 27. 2015).

TAS recently raised several concerns on letters Small Business/Self Employed (SB/SE) Examination uses to communicate with taxpayers about the information exchanged during an audit.[5] In particular, TAS was concerned with the 15-day condensed timeframe SB/SE Examination gave some taxpayers to respond to the IRS. Despite acknowledging TAS's concerns, the program owner proceeded with publication and did not make any additional efforts to reconcile TAS's differences. In this case, TAS did not get a chance to review these letters until after SB/SE submitted them to OTC, which called the letters "courtesy copies" and gave TAS five days to respond. After the letters generated public opposition, the IRS agreed to discontinue use of the letters. Had TAS received earlier notification and been granted more time to negotiate and elevate the use of the letters before publication, the IRS could have avoided embarrassment and taxpayers would not have been harmed.

TAS receives letters from the Office of Taxpayer Correspondence with as few as five business days to review... By working with TAS from the beginning of the review process, IRS could put taxpayers first, improving the efficiency of its reviews, saving resources, and minimizing taxpayer burden.

The IRS has recently adopted changes that streamline the IMD review process,[6] but these changes have substantially narrowed the scope of comments Operating Divisions (ODs) will accept during the clearance of their IRMs. Although these changes allow ODs to update their guidance and other documents faster, the new approach makes it more difficult for TAS to advocate for taxpayers and prevent problems arising from inappropriate or unclear guidance.

TAS has since worked collaboratively with the Tax Forms and Publications (TF&P) office to include TAS's suggestions during the update of key publications. We have also worked with the Servicewide Policy Directives and Electronic Research (SPDER) office to create guidance that gives all reviewers a way to send important comments to authors of IRMs. This new guidance recognizes the need to fully vet instructions and processes IRS uses. TAS will continue to advocate the IRS accept comments from internal stakeholders like TAS at the earliest opportunity and make a good faith effort to resolve differences of opinion.[7]

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- Collaborate with SPDER on implementing new guidance allowing all reviewers to provide comments to IRM authors;
- Seek out partners willing to revise guidance to include TAS earlier in the review process for letters and notices; and
- Reach out to the TF&P office to identify and implement ways to include TAS in the review process.

5 See Letter 5261, *Examination Report Transmittal - Additional Information Due (Claims for Refund)*, and Letter 5262A, *Examination Report Transmittal - Additional Information Due (No Change with Adjustments)*. For further discussion of the National Taxpayer Advocate's concerns, see Area of Focus: *Additional Requirement for Appeal Access and Compressed Case Timelines Impair the Fundamental Rights of Taxpayers, supra.*

6 See IRM 1.11.9.7(3), *Guidelines for Reviewers* (Dec. 4, 2014).

7 For information on how to fix this situation, see National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 97-8 (Area of Focus: *TAS Will Continue Advocating for a Servicewide Clearance Process for Tax Forms, Publications, Letters and Notices*).